INSIDE THIS WEEK: A 14-PAGE SPECIAL REPORT ON INDONESIA

The Economist

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Obama's big speech

A new merger boom?

Britain's ethical foreign policy

Bringing NASA down to earth

Russia's Vicar of Bray

Wall Street

One year on, what's changed?



Home
This week's print edition
Daily news analysis
Opinion
All opinion
Leaders
Letters to the Editor
Blogs
Columns
KAL's cartoons
Correspondent's diary
Economist debates
World politics
All world politics
Politics this week
International
United States
The Americas
Asia
Middle East and Africa
Europe
Britain
Special reports
Business and finance
About our new page
All business and finance
Business this week
Economics focus
Management
Economics A-Z
Business education
Markets and data
All markets and data
Daily chart
Weekly indicators
World markets
Currencies
Rankings
Big Mac index
Science and technology
About our new page
All science and technology
Technology Quarterly
Technology Monitor
Books and arts
All books and arts
Style guide
People
People
Obituaries
Diversions
Audio and video
Audio and video library
Audio edition
The World In
The World in 2009
The World in 2008
The World in 2007
The World in 2006
The World in 2005
The World in 2004
Research tools
All research tools
Articles by subject
Economics A-Z
Special reports
Style guide
Country briefings
All country briefings
China
India
Brazil
United States
Russia

Print edition September 12th 2009

Wall Street
Wall Street and the City of London survived thanks to state support. Now they need to be weaned off it: leader



Previous print editions
Sep 5th 2009
Aug 29th 2009
Aug 22nd 2009
Aug 15th 2009
Aug 8th 2009
More print editions and covers »

rica

Strife in Yemen
The world's next failed state?

The Palestinians' West Bank
Not as horrible as it was

A metro for the Emirates
All that glisters...

Africa's diplomacy over Zimbabwe
Robert Mugabe off the hook as usual

Zimbabwe's still-muzzled press
Alternative voices longing to be heard

Guns in Africa
Out of control

Europe

America and eastern Europe
End of an affair?

Germany's energy debate
Nuclear power? Yes, maybe

French criminal justice
A delicate judgment

Turkey, Cyprus and NATO
Fogh in the Aegean

Spain's growing budget deficit
Taxing times

Spain's judiciary
Judge Garzón in the dock

Charlemagne
Germany's oddly vapid election

Britain

The ethics of Labour's foreign policy
Angels and demons

Military exports
No farewell to arms

The airline bombers
Bang to rights

Politics and the spending squeeze
The chancellor's eyebrows

The growth of home tutoring
Top-up teaching

Teaching assistants
Unintended consequences

Televised election debates
Ready for his close-up?

Britain and Montenegro
An Anglo-Balkan moment

Bagehot
The end of the age of war

Articles flagged with this icon are printed only in the British edition of *The Economist*

International

UNESCO and World Heritage Sites
The limits of soft cultural power

UNESCO's leadership
A race or a death-wish?

Iran, North Korea and the bomb
Spinning dark new tales

Higher education and the recession
It still pays to study

Beaten but not broken

Books & Arts

Lehman Brothers and the crisis
A year on

The Fed and the crisis
Financial firefighting

Charles Dickens
An extravagant imagination

Seahorses
How odd, how lovely

British reportage
Goodbye to all that

Skellig Michael
An Irish riddle wrapped in a mystery

Obituary

Sergei Mikhalkov

Economic and Financial Indicators

Overview

Output, prices and jobs

The Economist commodity-price index

The Economist poll of forecasters, September averages

Trade, exchange rates, budget balances and interest rates

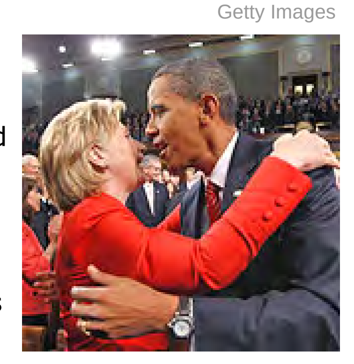
Markets

Education spending

Politics this week

Sep 10th 2009
From The Economist print edition

Getty Images



Congress returned to work after an August recess during which opponents of health-care reform gained the upper hand. In a televised speech to Congress, **Barack Obama** said "the time for bickering is over" and urged lawmakers to pass a meaningful bill. He also said he was willing to compromise on a rigid government-backed insurance scheme, such as by including an option that would trigger the plan if private insurance fails to meet a policyholder's needs. See article

Following the death of Edward Kennedy, **Christopher Dodd** declined the chairmanship of the Senate health committee. Mr Dodd oversaw the committee's work during Mr Kennedy's absence. He remains chairman of the banking committee, where some say he needs to refocus his energies.

Van Jones **stepped down** from his job as a junior adviser at the White House, on "green jobs", after a number of controversial comments he had made prior to his joining the administration came to light, as well as his signature of a petition claiming that George Bush had known in advance about the September 11th 2001 attacks. His resignation came after a concerted effort by conservatives to force him out.

Mr Obama's televised beginning-of-term speech to **schoolchildren** caused a flap. Some Republicans accused the president of trying to "indoctrinate America's children to his socialist agenda", though they later cooled their criticisms after it was noted that George Bush senior once did something similar in 1991, which in turn was criticised by Democrats at the time.

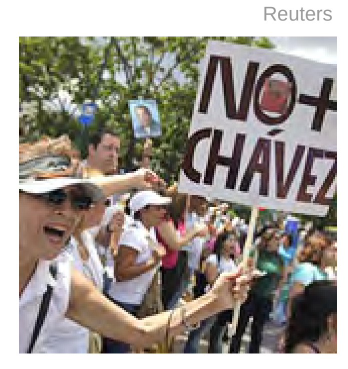
The scales of justice

Mexico's president, Felipe Calderón, shuffled his cabinet, dumping Eduardo Medina Mora, the respected attorney-general. He replaced him with Arturo Chávez, who was criticised by human-rights groups when chief prosecutor in the state of Chihuahua for failing to investigate the murders of women in Ciudad Juárez. Mr Calderón also proposed new taxes and spending cuts in a budget for next year. See article

A Bolivian religious fanatic briefly hijacked a **Mexican airliner**, ordering it to circle Mexico City. He told the crew he had three accomplices, whom he later identified to police as "the Father, the Son, and the Holy Ghost."

During a visit by Nicolas Sarkozy to Brasília, **Brazil** said it was negotiating to buy 36 Rafale fighter jets for $2.2 billion from **France**. Brazil has already agreed to buy five submarines and 50 helicopters from France, which will share the technology involved.

Reuters



In **Venezuela**, tens of thousands of people marched in Caracas, the capital, in protest at a new education law that they say will lead to political indoctrination and at recent arrests of opposition activists. Officials threatened to shut down 29 more radio stations critical of Hugo Chávez's government.

Guatemala's government declared a "state of public calamity" in response to malnutrition that it said threatens 400,000 families.

Who your friends are

The Southern African Development Community, a club of 15 countries, backed **Zimbabwe's** President Robert Mugabe by calling for sanctions against him and his senior party colleagues to be lifted. Morgan Tsvangirai's party, which is in an awkward unity government with Mr Mugabe's, was disappointed when Jacob Zuma, South Africa's president, failed to press Mr Mugabe to fulfil his power-

sharing promises. See article

A **Sudanese** woman, Lubna Hussein, was found guilty of wearing trousers, a practice said by the authorities to be indecent. Her case has sparked an international furore. She was freed from prison after journalists paid a fine of $200 (against her wishes). She also faced up to 40 lashes if convicted, but that punishment was not imposed.

Fierce fighting continued in northern **Yemen**, where the country's president, Ali Abdullah Saleh, is trying to suppress a rebellion in the Saada region led by the Houthi clan. The UN says at least 50,000 people have been displaced in the past few weeks. See article

Iran's opposition leader, Mir Hosein Mousavi, whose supporters insist he won a disputed presidential election in June, told them to stay calm despite the recent arrest of several prominent reformers. Discord in the ruling establishment seemed set to persist.

Israel's prime minister, Binyamin Netanyahu, angered American and Palestinian negotiators by saying that 450 previously planned housing units in Jewish settlements on the West Bank should be built, despite demands for a complete building freeze.

Afghan inferno

In **Afghanistan**, scores of people, including civilians, were reported to have died in a NATO air strike in the northern province of Kunduz. The American strike was called in by a German commander after two oil tankers were captured by the Taliban. A British reporter, Stephen Farrell, who went to investigate the incident was kidnapped, and later freed by Western forces. His Afghan colleague was killed. See article

As votes were being counted in the Afghan **presidential election**, the incumbent, Hamid Karzai, pulled ahead and appeared on course to win without the need for a second-round run-off. But accusations of widespread rigging led the United Nations-backed complaints commission to order a partial recount. See article

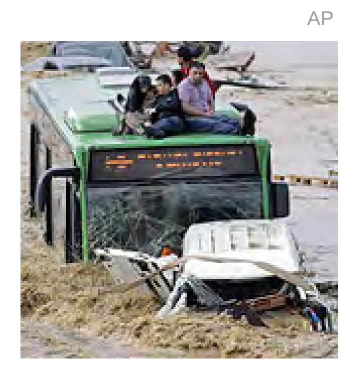
In **Australia**, police launched a war-crimes investigation into the deaths in East Timor in 1975 of the journalists known as the "Balibo five", believed to have been killed by Indonesian soldiers.

Jury decision

The retrial in **Britain** of eight men accused of plotting to blow up at least seven transatlantic airliners in 2006, using liquid explosives smuggled on board in soft-drink bottles, found three defendants guilty of conspiracy to murder the passengers. A fourth man was found guilty of conspiracy to murder without knowing the targets. The jury was unable to reach verdicts on three others, and acquitted one man. The al-Qaeda-inspired plot led to airports worldwide imposing strict limits on carrying liquids in hand luggage. See article

At least 23 people were killed in **Turkey** when floods swept through Istanbul, swamping houses and turning roads into fast-flowing rivers. Among the dead were seven women who drowned in a minibus that was taking them to work.

AP



Business this week

Sep 10th 2009
From The Economist print edition

Finance ministers from the G20 countries met in London to discuss the outline of a new framework for regulating finance ahead of a summit in Pittsburgh this month. The new rules, should they be adopted, would require banks to increase capital as a buffer against a downturn and ask **financial companies** to develop "living wills" that set out procedures for creditors to unwind a failed bank. The meeting was held almost a year after the collapse of Lehman Brothers, which helped trigger the world's worst financial crisis since the 1930s. See article

The ministers also discussed ways to implement uniform guidelines on **bankers' bonuses**. Separately, Lloyd Blankfein, the boss of Goldman Sachs, gave a speech in which he said anger about bankers' pay was "understandable and appropriate".

A 477-page report by the inspector-general of America's **Securities and Exchange Commission** concluded there were systemic breakdowns in the agency's oversight of **Bernard Madoff**. Mr Madoff was sentenced to 150 years in prison for his Ponzi scheme. The SEC first investigated Madoff-related funds in 1992.

Chewing it over

America's **Kraft Foods** launched a takeover bid for Britain's **Cadbury**, which rejected the £10.2 billion ($17 billion) offer as too low. The confectioner traces its roots back to 1824 when it was founded by Quakers. As well as chocolate it makes chewing gum, the worldwide market for which grew by almost half between 2004 and 2008. Kraft, which includes Toblerone chocolate among its brands, is to press Cadbury for a deal. See article

Suntory, a Japanese drinks and distilling company, was poised to make a bid for **Orangina Schweppes**, a European beverage-maker which used to be owned by Cadbury.

Deutsche Telekom and France Telecom announced a 50:50 joint venture in which they will combine their **T-Mobile** and **Orange** mobile-phone units in Britain. Deutsche Telekom will contribute £625m ($1 billion) to equalise the debt burden between the two firms and both brands will be maintained separately for 18 months after the transaction closes. The deal creates Britain's biggest wireless operator, with a combined 37% of the market for subscribers, vaulting ahead of Telefónica's O2 and Vodafone. Competition regulators will scrutinise the proposal.

Round one to Boeing

The World Trade Organisation found that preferential government loans received by **Airbus** breached WTO rules. The decision is preliminary and was not announced. America filed the complaint against Airbus in 2004, after which Europe countersued claiming the American government's aid to **Boeing** was illegal. An interim ruling on that case is expected in December.

Switzerland has the world's most **competitive economy**, according to an annual index from the World Economic Forum. America came in second place for the first time since 2004, when the WEF began compiling the data in their current form. In its ranking of the "soundness" of banks, America fell to 108th position, behind Tanzania. Britain was 126th, one notch below Burundi.

America's **unemployment rate** rose to 9.7% in August, its highest level since June 1983.

Gold prices traded around the $1,000-a-troy-ounce mark. Investors are turning to the metal (again) as a safer alternative to other assets amid low interest rates and worries about the dollar's status as a currency reserve. The greenback has fallen to its lowest level in almost a year against a

basket of currencies.



Sweden's **Koenigsegg**, a tiny maker of high-performance cars, said it would sell a minority stake in its business to state-run **Beijing Automotive Industry Holdings (BAIC)**. The deal helps Koenigsegg finance its purchase of Saab, which is being sold by General Motors. Meanwhile **Geely**, another Chinese carmaker, said it would require the help of a state-backed investment company in its probable bid for Sweden's **Volvo**, which is being sold by Ford.

Steve Jobs made his first public appearance since undergoing a liver transplant. Apple's boss took to the stage for a product launch at which he unveiled the latest version of the iTunes online-music service and a new range of iPod devices, including one model with a video camera.

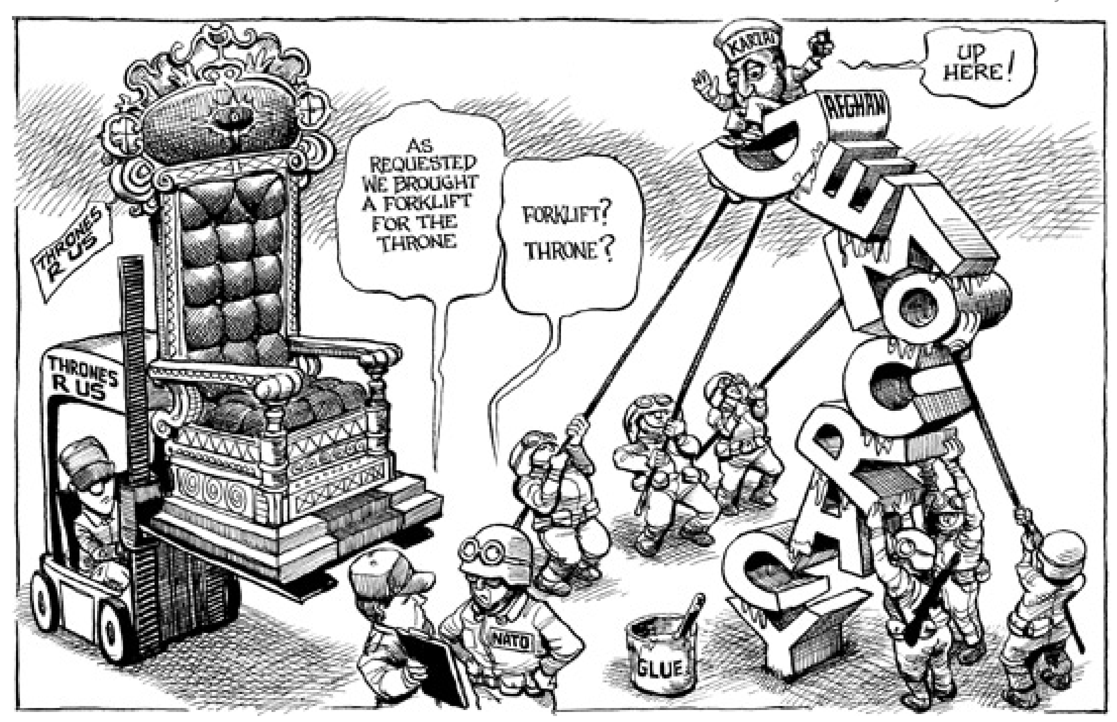
Return of the Fab Four

Contrary to rumours, the Apple event did not mention when the catalogue of songs by the **Beatles** would become available on iTunes. Negotiations have dragged on for months with EMI, which meanwhile issued boxed sets of remastered Beatles albums in an effort to revive its waning fortunes. Viacom released an elaborate new video-game based on the band.

KAL's cartoon

Sep 10th 2009
From The Economist print edition

Illustration by KAL



The financial industry

Unnatural selection

Sep 10th 2009
From The Economist print edition

Wall Street and the City of London survived thanks to state support. Now they need to be weaned off it

Illustration by Brett Ryder



"WE HAVE a long track record of pulling together when times are tough…We're on the right track." Thus spoke the boss of Lehman Brothers on September 10th 2008. Within five days Lehman had gone bust and it quickly became clear that the world's financial system had problems far beyond a single badly run investment bank and temporarily frozen credit markets. After two decades of expansion and deregulation, and the greatest bull market finance has ever known, many of the world's banks were dangerously undercapitalised. Governments were forced to step in, providing capital, loans and guarantees to banks. In America, the euro zone and Britain the sums involved so far amount to about one sixth of GDP.

A year on from Lehman that still looks like the right call. After the crash in 1929 America's economy shrank by a quarter and the unemployment rate hit 25%. This time round, with the banks wrapped in cotton wool, extremely low interest rates and big public-spending packages, the economic distress has been massively smaller. Yet the recession has still been extremely painful, prompting a sense of outrage at the financial industry and in particular the big wholesale banks that execute transactions for clients and trade on their own account. This reflects not just their past sins, but also the perception that nothing has really changed.

In a league of its own

That is not entirely true. Many bankers have lost their jobs. Some skyscrapers in Manhattan and London's Canary Wharf have new signs on them. Famous firms like Merrill Lynch have been swallowed up; the reputations of others such as UBS and Citigroup have been mauled. Plenty of hedge funds have folded. There have been relative winners, too. Many commercial banks have done well (particularly in Spain, Canada and Australia) and JPMorgan Chase, Bank of America and Barclays have expanded their investment banks (see article).

But the dramatic changes in the pecking order mask a lack of more profound change in the system of finance itself. Lehman aside, no big firms have been allowed to fail (as they would have done, unaided). Thanks to state aid, the law for big firms today is what Gordon Gekko, the red-blooded villain of the film "Wall Street", dubbed "survival of the unfittest".

Indeed, taken together, financial firms have not even really got smaller. Exclude "useful" loans to the real economy, and over the past year the remaining underlying risk-adjusted assets of the nine biggest investment banks worldwide have been broadly flat. Statistical measures of the maximum trading losses

these firms could face on those positions suggest that, in aggregate, they are taking more risk. Their combined balance-sheet is 40% bigger today than in mid-2005. And all this has been amplified into public outrage by the foolish decision to pay out bumper bonuses again.

The fury at "business as usual" in the Temples of Mammon is understandable, but it is a rotten basis for trying to regulate finance. For one thing, the recent return of profits and bonuses has occurred in unusual circumstances: it is easier for healthier banks to make profits when their weaker rivals are cowed. Once competitors are back on their feet and tighter regulations introduced, things will look very different. Far from being the return of the big bonuses, this could be their last hurrah.

And bonuses are, for the most part, the symptom not the disease. They certainly have done damage, persuading traders to load the system with toxic securities and sucking away capital: in the year before its demise, Lehman paid out at least $5.1 billion in cash compensation, equivalent to a third of the core capital left just before it failed. More recently Morgan Stanley promised so much pay in its latest quarter that it almost made an underlying loss. In any other business that would be a risk for shareholders. But finance's risks are everyone's because banks rely both directly and indirectly on taxpayers' support.

The scale of that help is huge. Loans from central banks and debt guarantees alone amount to $2.7 trillion. As with any private industry in receipt of almost unlimited cheap public funds, finance now has every incentive to be as big as possible—beyond the point of usefulness. Change the assumptions behind this weird system, and everything else, including pay and the heads-I-win, tails-you-lose culture, will move too.

Removing the explicit side of the state's commitment is relatively simple. Some guarantees are still plainly needed now, but a firm deadline of, say, five years for the final expiry of the governments' various crisis-induced pledges should be set globally. With the world economy in better shape, this looks more realistic than it did six months ago. But even then the implicit assumption will linger that banks will always be bailed out. This is the core problem. There are two possible responses to it: regulate banks to try to make them safer, and attempt to limit the implicit guarantee. Both approaches are now needed.

Taming the beast

On regulation there have been some wacky ideas. Britain's top financial policeman has endorsed a tax on transactions to cut the industry down to size, an idea that is Utopian and misguided. Similarly, the idea that regulators know the optimal size of the financial sector, or are good at running banks, is a fantasy. Trying to prevent blow-ups in the first place is more sensible with economy-wide "macro-prudential" regulators working to counter bubbles such as the recent housing mania.

Booms and bust will not disappear; hence the crucial importance of bolstering capital, the buffer that banks depend on to absorb losses. At the top of the last cycle, capital levels would have needed to be about double the current permitted floor for America's banks to have got through the crisis without raising more funds. The Basel club of regulators is working to raise the level and improve the quality of banks' capital. It may also be possible to vary capital charges to prod banks to shrink, improve liquidity and, yes, curb pay. But capital, a fairly blunt tool, could be asked to do too much.

The same is true of regulators themselves. Last time round they were meant to stop banks from self-harm and make sure they had enough capital. Just because they are trying harder now does not mean they will succeed. Focus only on more rules and the medium-term risk is of a colossal, semi-socialised banking system crawling with outgunned, possibly captive regulators. Hence the importance of the second response: a concerted effort to reduce the implicit state guarantees.

That is easier said than done, especially since the recent bail-outs have reaffirmed the state as a backstop. There are, however, other options. "Living wills" can force banks to plan for their own collapse, which should make it easier to protect depositors while forcing creditors, not taxpayers, to bear the pain. There is also a case for forcing banks to finance themselves with a slice of junior "hybrid" debt (which has never been state-guaranteed). Its cost, and thus banks' profits, may at least for a while be more sensitive to the risks being taken.

No one should pretend that banking is an industry where pure natural selection takes place. But as guarantees, both explicit and implicit, are withdrawn, the hope is that self-discipline will be imposed on banks, not just swathes of new regulation. There are signs that riskier banks are already paying more to finance themselves. This differentiation must be promoted, so the weak and reckless are gradually forced

to shrink and live within their means—and not off taxpayers' largesse.

Indonesia's future

A golden opportunity

Sep 10th 2009
From The Economist print edition

Despite the apocalyptic visions of a decade ago, Indonesia is a huge success. But it should aim higher

AFP



WHEN Suharto, Indonesia's long-serving dictator, fell in 1998 the very integrity of the country seemed in doubt. It faced economic collapse, political chaos and fissile separatist insurgencies in Aceh, Papua and East Timor. Indonesia's neighbours feared the worst: anarchy within Indonesia; a surge in Islamist extremism; an exodus of desperate boat-people; rampant piracy in some of the world's busiest shipping lanes.

In contrast, present-day Indonesia seems almost a miracle. As our special report in this issue describes, it is a stable, largely peaceful democracy with a resilient economy growing at a respectable lick. It is intact—minus what is now independent Timor-Leste. Despite July's suicide-bombing in Jakarta, Islamist extremism has been marginalised and, in the world's largest Muslim-majority country, moderation rules. Indonesian policymakers, naturally, congratulate themselves on having steered the country away from the abyss. But that is complacent. Instead, policymakers should be worrying about the fragility of the gains they have made, and about how far the country still is from realising its potential.

The president, Susilo Bambang Yudhoyono, has a rare chance to try. Re-elected in July with a thumping majority, his Democratic Party also now has more seats than any other in parliament. This, claim his boosters, will allow him to stack his cabinet with competent technocrats and to shake off the timidity with which he pursued reform in his first term. Cynics counter that the former general, who turned 60 this week, is unlikely to shed the dithering habits of a lifetime. Boldness, however, is required: in reforming the economy; intensifying the battle against the scourge of corruption; and entrenching solid democratic processes.

In stark contrast to its shipwreck during the Asian financial crisis of 1997-98, Indonesia has sailed through the credit crunch without leaking much water. GDP is expected to grow by more than 4% this year. Fiscal restraint and sustained domestic demand have given the economy solidity. They have not, however, translated into the reduction in poverty that Mr Yudhoyono promised when he came to power in 2004. Nor does Indonesia have a business climate that would allow the economy to grow at the annual 6.5% it averaged under Suharto, let alone the double-digit rates achieved by China.

Some indicators of poverty, such as the rate of child-malnutrition, have scarcely improved since 2000, and others, such as the incidence of maternal mortality, are far worse than in many countries with a similar national income per head. In part this is a failure of government spending. About half of its discretionary expenditure goes on fuel, electricity and other subsidies, which tend to benefit the well-off. And a politically important devolution of power and resources has worsened an old problem: that Indonesian governments lack the capacity to spend money as fast as they should.

With its huge domestic market—some 240m people—Indonesia ought to be the natural hub for businesses seeking a regional niche in South-East Asia. But unfriendly policies continue to drive firms elsewhere. Just this week the World Bank's annual report on the ease of doing business around the world (see article) ranked Indonesia 122nd out of 183 countries, below, for example, Bangladesh, Ethiopia and Guatemala. Red tape, petty protectionism, restrictive labour laws and confusion between different levels of government deter investment.

So does corruption. One of Mr Yudhoyono's great selling-points is his clean image. A campaign against graft has seen even his daughter-in-law's father behind bars. The anti-corruption drive has had an impact, partly thanks to the work of an independent commission, known as the KPK. That is presumably why the KPK's powers are under threat from the parliament, which may yet whittle them away.

A process not a destination

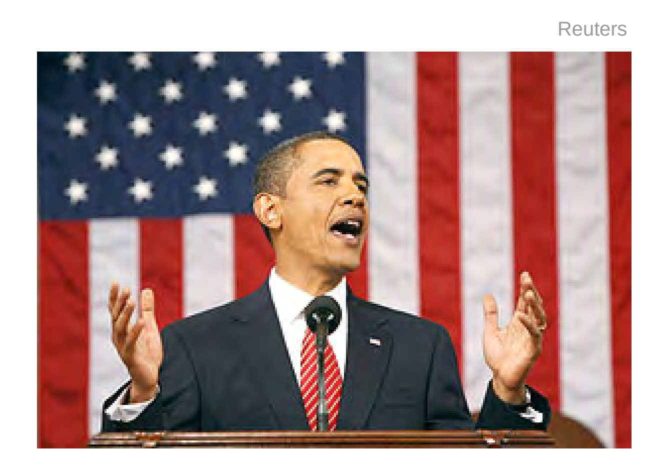
Nor can Indonesia's most astonishing achievement of all be taken for granted. Although it has established a functioning democracy in a short period, other candidates in July's election challenged the results. They had a point. The election was badly flawed. There was nothing like an Iranian- or Afghan-style rigging—the abuses seemed more random than systematic. But what really calmed tempers was the margin of Mr Yudhoyono's victory. Before the next election, a more robust process is essential. Dictatorship already seems a distant memory; the notion of a coup laughable. But much the same was said of Thailand a decade ago, a few years before the army stepped back into politics. Indonesian democracy seems to have firmer foundations, but it would be a serious mistake to assume that they are fully built.

The art of the possible

Sep 10th 2009
From The Economist print edition

A fine, measured piece of oratory from the president. But there is still tough work to do

Reuters



“I AM not the first president to take up this cause, but I am determined to be the last.” Thus Barack Obama, late in the day, took his quest to reform America’s expensive and flawed health-care system to the floor of Congress with a mighty speech that will surely stand as one of the defining moments of his presidency, whether it leads to eventual triumph or disaster. His is a bold ambition indeed; but this week the president looked a bit closer to fulfilling it.

Politics, as everyone knows, is the art of the possible; and there have been times over this ill-tempered summer when the idea of tackling a system that costs almost twice as much as any other rich country’s, yet yields substandard results and leaves tens of millions of people with no health insurance at all, has seemed simply impossible. Mr Obama has to find a package of policies that is fiscally and politically moderate enough to win over a vital few Republicans to his side (and also prevent the defection of nervous conservative Democrats). But at the same time he has to keep the support of the leftish Democratic Party base, which wants to see a more expansive and costly set of reforms. He may well fail. But on September 9th the president for the first time laid out in some detail what such a plan might look like. Cleverly borrowing good ideas from both sides of the party divide, his proposals at least look like a plausible basis for agreement (see article).

The plan obliges everyone to take out health insurance while creating a tapering subsidy for poorer families to help them afford it. It also requires insurance companies to end various nefarious practices, such as refusing to insure people with existing conditions or cancelling their coverage just when they need it most. To pay for these long-held liberal goals (the cost is put at $900 billion over ten years), the president has committed himself to several policies that Republicans, if only they could remove their partisan spectacles, should applaud.

There is, for instance, a tax on insurance companies that offer “Cadillac” plans to richer individuals; since this will inevitably be passed on to consumers, it is a useful step towards making individuals aware of the cost of their coverage. He has made a cast-iron pledge that he will not sign a health bill that increases the deficit, and has promised automatic spending cuts if savings do not materialise. He wants to set up a new technocratic committee that could mandate changes to the hugely expensive Medicare system of health care for the elderly (an idea that cleverly takes such difficult decisions out of the hands of politicians, who have displayed a lamentable failure to grapple with them). And the president also promised conservatives reform of America’s mad tort system. The risk of being sued pushes up costs, obliging doctors to practise “defensive medicine” in the shape of needless tests and procedures.

Give me public options, but not now

Still up in the air is the trickiest question of all: whether the government should create a "public option", its own insurance provider, which people could use if they dislike what the free market has to offer. Medical insurers and most Republicans say a public plan would enjoy unfair advantages and destroy competition. Liberal Democrats say the insurers will not cut prices without it. Both sides have a point. This newspaper still thinks the best solution would be to keep the public option as a threat: to set up a formal provision in the bill whereby a public plan would be introduced in, say, five years' time if certain targets were not met. In his speech Mr Obama hedged his bets, sticking with the public option but signalling a willingness to compromise. This may come back to haunt him. But overall, this performance was a big step forward.

Elections in Afghanistan

Re-rigging Hamid Karzai

Sep 10th 2009
From The Economist print edition

The fraud-ridden election is an opportunity to shift power away from the flawed president

AFP



TO MOST people, ballot boxes containing a unanimity of votes for just one out of 36 candidates in an election might raise a suspicion of cheating. Not so Hamid Karzai. A bit of fraud is inevitable in any young democracy, he says, but Afghanistan is a tribal society where "people vote collectively"; it is not odd for everybody in a district to support him. The Afghan president says he will not only match his victory of 2004, when he won more than 54.5% of the vote, but surpass it. Indeed, the slow counting of the votes this week seemed likely to bear him out.

Yet the ballot-stuffing has been too crude, security conditions too acute and disillusionment too palpable for anyone to believe such results. Mr Karzai's main challenger, Abdullah Abdullah, a former foreign minister, speaks of "massive state-sponsored fraud". The country's electoral-complaints commission says there is "clear and convincing evidence of fraud" and has ordered an audit of districts where turnout was 100% (or more) or one candidate won more than 95% of votes.

An election that was meant to refresh the decaying leadership of Mr Karzai has made him appear even more rotten. The country risks starker polarisation between Tajiks in the north and Pushtuns in the south. The fight against the Taliban has become harder. The more predatory and corrupt the government, the more difficult it will be to draw Afghans away from insurgents, and the harder to convince the Western public to send soldiers to die for its sake. In the words of America's counterinsurgency manual, now akin to a warfighters' bible, "legitimacy is the main objective." Gordon Brown, the British prime minister, wants greater "Afghanisation". But how can that work when the West's Afghan ally has lost legitimacy?

Generals and politicians struggle for answers, but withdrawing Western forces now should not be one of them. This would lead to the restoration of the Taliban and the return of al-Qaeda to the haven it lost when it was chased out of Afghanistan. Global jihadists must not be allowed to claim victory in Afghanistan. They remain a deadly threat—as shown by the conviction in Britain this week of a group that had plotted to blow up transatlantic airliners in 2006.

Preside over the president

So the unhappy options for the West are to try to reset the election, or reset Mr Karzai. In even a half-perfect world the natural response to a cheated election would be to hold another one—indeed, America at first urged Mr Karzai to re-rig the ballot so that he would win less than 50% and could thus at least hold a fairer second round. Sadly Afghanistan is a long way from even a half-perfect world; it is not even Iran, the last place to have such an obviously fiddled result. Another round would be expensive, dangerous and

divisive. A proper poll would take months to organise: nobody has a decent census of the country. So it would probably be no less corrupt and be won anyway by Mr Karzai, further embittered by what he thinks is a Western plot to rob him of victory. (The thankless task of untangling fake votes from real ones falls to an electoral watchdog dominated by UN-appointed foreigners.)

In practice then the West, alas, has little alternative other than to try to make Mr Karzai a better ruler. The tragedy is that he would probably have won a clean vote: he is still the closest thing Afghanistan has to a national leader. The West should use the dodgy election as a pretext for political change. The Afghan state is weak, yet too many of its powers are vested in the president. One option would be for Mr Karzai to appoint a "chief executive", with the president withdrawing to become a "father of the nation". But the deeper need is to push power to the regions. In a complex and disparate country, the true face of government is usually not the president or his ministers, but the provincial and district governors. Yet they lack the power to raise funds or to allocate spending.

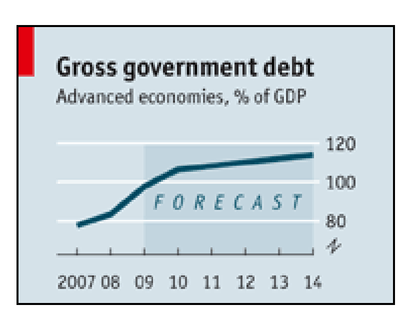
A partial answer to the failure of electoral politics is to reconvene a *loya jirga*, a big tribal assembly that proved vital in the early part of the post-Taliban transition, to rewrite the constitution. This would soothe Mr Abdullah, provide a forum to rebuild political consensus, draw in reconcilable Taliban figures—and cut Mr Karzai down to size.

Fiscal policy

The other exit strategy

Sep 10th 2009
From The Economist print edition

Independent budget offices would help politicians' promises to be prudent tomorrow



ECONOMIC policymakers across the rich world face two delicate balancing acts over the new few years. The first, involving monetary policy, is being widely discussed and carefully planned by teams of technocrats. Central bankers must keep their balance-sheets big and interest rates low for long enough to prevent deflation setting in, but they also have to be prepared to change things quickly to prevent inflation taking off. The second balancing act, involving fiscal policy, depends on politicians rather than specialists—and has, so far, been shamefully ill-planned.

In the short term public largesse is a necessary response to the slump in private demand. Budget deficits have ballooned—to an average of almost 10% of GDP across the big, rich countries—for good reasons, as governments have bolstered their banks and provided fiscal stimulus, and as sagging economies have sapped tax revenues. Withdrawing that support too fast would be foolish. Particularly after a banking bust, premature fiscal tightening can push weak economies back into decline, as Japan's ill-timed consumption-tax increase in 1997 showed. The same risk holds today, particularly if the fiscal squeeze involves incentive-dulling tax increases.

But public profligacy cannot last for ever. Even if the nascent recovery takes hold, the IMF reckons the gross government debt of the rich world's big economies will reach an average of 115% of GDP by 2014 and continue to rise thereafter in some places, notably America. The weight of this debt will eventually push up interest rates, crowd out private investment and sap economic growth. Far nastier outcomes, from out-of-control inflation to outright default, are conceivable.

To be fair to the politicians, this fiscal balancing act is far harder than the central bankers' task, for two reasons. First, politicians must not only get the timing of fiscal tightening right, but must also decide on the best ways to cut spending and increase taxes, and the right mix between the two. These decisions involve more goals, more tools and more politics than stabilising prices. Second, politicians lack the credibility that central bankers have built up after two decades of low inflation. The first of these differences is inevitable: decisions about the size of government and its priorities are profoundly political and politicians must answer to voters for their choices. But politicians could go a long way towards building credibility for their fiscal decisions by copying more of the tricks of modern monetary policy.

Over the past 20 years central banking has been revolutionised. A powerful consensus has emerged that economies perform better if monetary policy is left to an independent group of experts with a clear mandate (usually an inflation target) and that transparency around central bankers' assumptions and actions helps anchor people's expectations of future inflation. Some of this focus on rules and transparency has already rubbed off on fiscal policy. Countries from Sweden to Chile have rules to limit deficits and enforce transparent budgeting, and independent bodies to assess politicians' budget decisions. America has the Congressional Budget Office (CBO) and the euro zone has the Stability and Growth Pact (see article). By and large, though, these tools for fiscal credibility have been less well developed, less widely adopted and generally less effective than their monetary equivalents. That must change.

Transparency's clear benefits

One route emphasises fiscal rules. Germany, for instance, recently passed a constitutional amendment to limit the build-up of debt. Rules have worked well in some places, notably Chile. But often such rules have been discredited by manipulation—think of Britain's Golden Rule, which permitted borrowing only to invest over the economic cycle. If too strict, they could force premature tightening. Just as an inflation target is important, but does not by itself make central bankers credible, so a fiscal rule is a start, not a cure-all.

Hence the importance of the other approach: appointing independent budget monitors. Politicians will not (and should not) outsource tax and spending decisions to unelected technocrats, but all countries should have independent bean-counters to pass judgment on their fiscal plans. Even without statutory power, such bodies have an impact. New cost estimates from the CBO, for instance, recently changed the terms of America's health-care debate. These bodies should not just assess politicians' plans, but offer simulations of different fiscal paths. Britain's Tories want to copy the CBO model.

They are right. No politician likes being second guessed, but the greater fiscal credibility that such rules and institutions provide actually increases a finance minister's room for manoeuvre. It also helps central bankers, by assuaging investors' fear that bankrupt governments will resort to printing money. Credibility will not magically remove the difficult budget choices that lie ahead. But it is an important place to start.

Proliferation from North Korea and Iran

Will Russia and China pitch in?

Sep 10th 2009
From The Economist print edition

It's now or never if they want to stop Iran following North Korea

Illustration by David Simonds



FOR those who wouldn't know Kim Jong Il's uranium from his plutonium, the North Korean dictator's boast that he is now experimenting with a second, uranium-based, route to the bomb may merit no more than a shrug. Yet it contains an urgent message for the world. Mr Kim has made a habit of defying the United Nations Security Council by conducting missile and nuclear tests. And the repeated, unabashed character of his nose-thumbing is encouraging others with nuclear ambitions to think they could get away with it too.

Right now that means Iran, in the dock again this week at the International Atomic Energy Agency (IAEA), the UN's nuclear guardian, over its refusal to provide answers about its own nuclear work. Just as troublingly, China and Russia, for years North Korea's protectors at the UN, seem unready to learn the lesson from what Mr Kim is now doing and to restrain Iran. They should rethink their priorities before it is too late.

Nothing to hide?

Diplomats from America, Britain, France and Germany, along with China and Russia, are gearing up for another—possibly final—effort to persuade Iran to suspend its military nuclear work long enough to negotiate a package of incentives that could defang its ambitions (see article). But the effort will fail unless Russia and China are also prepared to help threaten the sort of painful sanctions that might give even Iran's committed nuclear enthusiasts pause. With Mr Kim only too eager to show where inaction can lead, what is stopping them?

Neither Russia nor China is happy to see Mr Kim flaunt his bombs. China appeared shocked and angry when he conducted some recent nuclear and missile tests. For years it had used the threat of its veto to keep North Korean adventurism off the Security Council's agenda. So Mr Kim may have been equally startled when China suddenly agreed to UN resolutions condemning his actions and slapping sanctions on his weapons trade. Welcome though this change of heart was, it was too little and came far too late. Even now, there is little sign that China, worried that upheaval in North Korea could spill over its borders, will exert enough pressure to get Mr Kim to start the disarmament he agreed to under a deal in 2005.

The fallout from a nuclear-armed Iran would be still more destabilising. Yet Russia and China have both so far put more weight on their big commercial and other interests in the country. It is an increasingly dangerous miscalculation.

So far as anyone knows, Iran is not yet at the nuclear threshold that Mr Kim so gleefully crossed with his first nuclear test in 2006. Indeed, Iran claims to have no interest in a bomb. Yet it is openly working on missiles that could deliver one and on the techniques that could produce sufficiently enriched uranium or else plutonium for a weapon's fissile core. Meanwhile inspectors have gathered enough evidence from different members of the IAEA's board to suspect that Iran has already been working to develop a nuclear warhead—precisely the charges that Iran now refuses, point-blank, to address.

Like Libya, which owned up to a once-secret weapons programme, Iran and North Korea got their start in the uranium-enrichment business from the nuclear black market run by Pakistan's disgraced Abdul Qadeer Khan. Like Libya, they may have been given a bomb design too. But even if Mr Khan was less helpful than is feared, it would be dangerous to assume that the close co-operation between North Korea and Iran in missile testing stops righteously short of nuclear matters: someone helped Mr Kim get his enrichment machines going. And Mr Kim, who has secretly helped Syria in the past and is rumoured to be assisting Myanmar now, has skills useful to Iran in plutonium-making and warhead-tinkering.

The closer Iran gets to the nuclear line that Mr Kim has crossed, the greater the damage and the wider it will spread. Sudden interest in "civilian" nuclear power around the oil-rich Gulf shows that Iran's neighbours are hedging their bets. If Russia and China are to contain the danger, the time is now.

On the Lockerbie bombing, “birthers”, Africa's population, responsibility to protect, “Inglourious Basterds”

Sep 10th 2009
From The Economist print edition

Lockerbie questions remain

SIR – Our son was killed in the Lockerbie disaster. He was on his way to spend Christmas with us in New York, where we were living at that time. We read your article following up the decision to release Abdelbaset al-Megrahi (“Nowhere to hide”, September 5th). UK Families Flight 103 is a group of relatives and friends of most of the British victims of the Lockerbie bombing. When the group was founded in 1989, it adopted the maxim “The Truth Must Be Known”. After more than 20 years we are still asking for answers to many more crucial matters concerning the disaster.

Members of the group have varying views about the guilt or innocence of Mr Megrahi, which colour their reaction to his release on compassionate grounds. Some think that he is innocent. Others, including ourselves, believe that we are not in a position to know whether he was involved in some way or not, since much of the evidence at the trial was circumstantial and unconvincing to many, including an official UN observer and a prominent academic who is an authority on Scottish law. It is also a fact that in 2007 the Scottish Criminal Cases Review Commission, after considering the matter for more than three years, concluded that there were six grounds for an appeal against the verdict in Mr Megrahi’s trial.

It is deeply disappointing that the appeal has now been—unnecessarily, in the case of compassionate release—abandoned. We were expecting to learn something new from the evidence we understood would have been presented. We still hope that some way will be found to release the evidence and our members are united in continuing to demand a full independent inquiry into the whole Lockerbie story. We have asked for such an inquiry many times in meetings with past and present senior government ministers, including Tony Blair. We were appalled that the ratification of the prisoner-transfer agreement, which stipulates that there must be no ongoing criminal proceedings if a prisoner is to be released, took place just as the first part of Mr Megrahi’s appeal was about to begin.

We are now hearing much talk of realpolitik, but we believe this has been the case right from the night of the crash. Why else would there be such difficulty in establishing answers to questions about, for example, the motive for the bombing of a Pan Am flight? The American attack on Tripoli in 1986 was said by Margaret Thatcher to have resulted in a marked decline in terrorist activity from Libya. Retaliation from Iran for shooting down one of its passenger jets by the Americans in July 1988 remains a distinctly plausible motive. We are told no evidence could be found to involve Iran, but we wonder how much effort went into finding evidence at a time when it would have been highly inconvenient to accuse that country or Syria.

Another unanswered question is about who else was involved. No one believes that Mr Megrahi could have operated alone and he was charged with “acting in concert with others”. Somehow, it has not been possible to establish who these others were. Surely, this is a major failure of the criminal investigation team? There were also numerous recorded warnings, some very explicit, and a prediction from the International Civil Aviation Organisation that retaliation from Iran was likely. We would like to know why the intelligence and security services failed to stop what was described at the Fatal Accident Inquiry as “a preventable disaster”.

It cannot be useful in preventing further terrorist attacks for Lockerbie to remain “a mystery”, as it was called recently by a well-informed academic. And the victims’ families surely have the right to know the full truth about the tragedy in which their loved ones died.

Jean and Barrie Berkley
Hexham, Northumberland

Debating the constitution

SIR – There is a widespread misconception that America's constitution requires a president to have been born in the United States, which forms the basis of the challenge from "birthers" to the legitimacy of Barack Obama's presidency (Lexington, August 22nd). The constitution requires only that the president is a citizen at birth: "No person except a natural born citizen, or a citizen of the United States, at the time of the adoption of this constitution, shall be eligible to the office of president…"

One way to satisfy this requirement is to be born in the United States. Another way is to be born outside the United States to a parent who is a United States citizen and satisfies certain statutory requirements concerning prior residence in the United States.

Hyman Gross
Corpus Christi College
Cambridge

The generation cap

SIR – Your briefing on the "demographic dividend" from having fewer children in Africa used optimistic demographic projections ("The baby bonanza", August 29th). We cannot assume that "contraceptive use is likely to rise sharply" on the continent or that progress is a foregone conclusion. Two-thirds of sub-Saharan countries have experienced no significant fertility decline in recent years, in part due to contraceptive shortages. These rates remain high in large measure because of the decline in funding for contraceptives by wealthy donor countries over the past decade.

Elizabeth Leahy Madsen
Researcher
Population Action International
Washington, DC

* SIR – Pursuing the demographic transition will require vision and courage from the region's governments because a decline in fertility will not simply happen through socioeconomic development alone. It needs to be triggered by policies such as universal female education, access to modern family-planning methods, institutional changes, and legal reforms, including raising the age at marriage.

Unless women are able to make meaningful choices about their reproductive lives, the demographic transition may be too slow to capture the demographic dividend.

John May
Demographer, Africa region
World Bank
Washington, DC

* SIR – Africa will never escape from the threats of hunger, violence and environmental destruction spelt out so vividly in your briefing until economists understand why women have smaller families. The difference between the Asian economic miracle and African stagnation is that Asia set up highly effective family-planning programmes to meet the needs of women who wanted fewer children.

African women want fewer children, but contraception is practically non-existent and abortion laws are highly restrictive. In January 2009, a gathering of international experts at the University of California, Berkeley, concluded that: "Meeting the unmet need in family planning has been highly successful in slowing rapid population growth. Ready access to contraception and safe abortion has decreased family size, even in illiterate communities living on less than a dollar a day."

Ndola Prata
Martha Campbell
Malcom Potts
Bixby Centre for Population, Health and Sustainability
University of California, Berkeley

* SIR – Two misconceptions have served to stymie the necessary political action for those of us working to reduce child mortality and to improve children's health.

First, there is a myth that reducing child mortality will further accelerate population growth on an already

crowded planet. The opposite is the case. Cuts in child mortality, as a result of targeted health and nutrition interventions, alongside the provision of modern contraception, help to reduce rates of fertility and to slow and stabilise population growth.

Second, it is often thought, if rarely said, that keeping very poor children alive is essentially futile, saving them for a life of desperate poverty and misery. Quite apart from the callous inhumanity of this position, the evidence does not support it. Reducing mortality and fertility rates is a powerful stimulus to economic development. Recent work by Save the Children and the Overseas Development Institute shows that a 5% reduction in child-mortality rates is associated with a one percentage point increase in economic growth over the subsequent decade.

David Mepham
Director of policy
Save the Children UK
London

* SIR –You correctly state that "if it is to feed its people, Africa badly needs a green revolution. In those parts with plentiful rainfall and rich soil—wet Africa—the prognosis is reasonably good. But in bigger dry Africa...efforts to replicate Asia's green revolution have so far failed."

Efforts to "replicate" Asia's green revolution will always fail in climates like this. Ironically, techniques that would succeed were pioneered in arid Africa, and have been adopted very successfully in many other arid (even drought-stricken) parts of the world. This does not involve just crops.

By moving cattle in tightly packed herds from place to place, the natural behaviour of grazing animals is replicated. Usually referred to as planned grazing, or holistic management, the technique results in much more fertile soil: hoofed animals produce fertiliser, after all, and will even till it into the soil for you, if you keep them stepping lightly enough.

Scott Agnew
San Francisco

SIR – You made some useful recommendations for Africa to avoid a "Malthusian collapse". But although Thomas Malthus is famous for his dire predictions regarding the inability of agricultural production to match population growth, he is less well known for his remedy for the very same problem. He wrote:

> The first grand requisite to the growth of prudential habits is the perfect security of property and the next perhaps is the respectability and importance which are given to the lower classes by equal laws and the possession of some influence in framing them. We have been miserably deficient in the instruction of the poor, perhaps the only means of really raising their condition.

Malthus advocated defined property-rights, the rule of law, representative government and universal education, much as you recommend but a few hundred years earlier.

Jeff Bennett
Professor, school of economics
Australian National University
Canberra, Australia

The responsibility to protect

* SIR – You were understandably sceptical about the probable outcome of the debate on mass-atrocity crimes scheduled for the UN General Assembly at the end of July ("An idea whose time has come—and gone?", July 25th). For the record, please allow me to report that it did not in fact end in tears. In the 94 statements made, only four states—Venezuela, Cuba, Sudan and Nicaragua—sought to roll back the consensus achieved in 2005 that sovereignty in this area was not sacrosanct. There was powerful support from many countries, such as Rwanda and Timor-Leste, which have suffered horrific violence, and a real commitment from big regional countries, for instance India, Indonesia, Brazil and South Africa.

Nobody underestimates the institutional and political challenges in implementing the new norm in practice, and plenty of cautions were expressed in the debate. But despite the best efforts of a handful of spoilers, the responsibility to protect is alive and well.

Gareth Evans
President emeritus
International Crisis Group
Melbourne, Australia

A baseball diamond

SIR – I wonder if the "Jewish baseball slugger" in Quentin Tarantino's "Inglourious Basterds" is a demonic caricature of Moe Berg ("Making the unfunny funny", August 29th). Berg, a catcher and coach, left baseball to join ALSOS, the Allied operation to monitor Nazi nuclear science. He was summoned to Switzerland by Allen Dulles, who at that time was station chief for the OSS, and asked to assassinate Werner Heisenberg. The head of ALSOS had declined the task on the ground that "physicists do not shoot other physicists."

Berg had no qualms about packing a pistol at Heisenberg's physics seminar. However, his experience in the classroom left little doubt that Heisenberg was a klutz in matters of bomb design, and as a matter of principle, Berg let him go unslugged.

Russell Seitz
Fellow, Department of Physics
Harvard University
Cambridge, Massachusetts

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* Letter appears online only

India's water crisis

When the rains fail

Sep 10th 2009 | VEERALAPALAM, ANDHRA PRADESH, AND LUBANA TEKU, PUNJAB
From The Economist print edition

Many of India's problems are summed up in its mismanagement of water. Now a scanty monsoon has made matters much worse

Reuters



RAINFALL last month encouraged Haniya, a middle-aged member of the Lambada tribe of southern Andhra Pradesh (AP), to inspect his one-acre (0.4-hectare) field. Some speckles of green, to show the red earth had held enough water for weeds to shoot, would have tempted him to sow cotton. But, towards the end of AP's monsoon rainy season, the field was parched and bare. If it rains again, Haniya may sow. If not? He gave the reply of peasant farmers in India and poor, dry places everywhere: "Only God knows."

Back in his village of Veeralapalam, light-skinned Lambadi farmers gathered. Most had scattered some cotton or lentil seed after the rain. But it had better rain again: none had access to irrigation from a dozen wells sunk 90 metres into central India's lava bedrock by richer high-caste Hindu farmers. A few expected to buy a dousing or two of costly piped water, brought by the same neighbours from a nearby storm-creek. Even if affordable, said Saidanayak, this would not sustain his hoped-for acre of cotton. Without more rain, it will fail, adding to his 125,000-rupee ($2,500) debt—a big sum, when the dowry for a Lambada bride is $1,200.

With no crop, no money and three daughters to marry off, he would join the only reliable flood in AP in these drought days: of thousands of tough, skinny peasants into Hyderabad, the state capital, in search of a day-wage. Asked what he would do there, Saidayanak pushed out his fists and shifted from foot to foot, as if cycling a rickshaw—and laughter diluted the gloom.

Many Indians share his worries. Around 450m live off rain-fed agriculture, and this year's monsoon rains, which between June and September provide 80% of India's precipitation, have been the scantiest in decades. Almost half India's 604 districts are affected by drought, especially in the poorest and most populous states—such as Bihar, which has declared drought in 26 of its 38 districts. Uttar Pradesh (UP), home to 185m, expects its main rice harvest to be down by 60%. The outlook for the winter wheat crop is also poor, with India's main reservoirs, a source for irrigation canals, one-third below their seasonal average. That also means less water for thirsty cities, including Delhi, where 18m people live and the water board meets around half their demand in a good year.

Belated cloudbursts in AP and other states have brought relief. But late sowing tends to produce a thin harvest. AP counted some 20 farmer suicides last month, and there will be more. A short drive from Hyderabad, Koteswara Rao watched as four Hindu outcasts and two blue-horned bullocks ploughed his 16 acres (14 of them leased) for cotton. If it fails he will be left with a $4,000 debt and, being of lofty caste, he said, he could never sweat it out as a labourer. "Suicide would be easier."

No one should starve, at least. None of India's previous five big post-independence droughts caused famine. And after two bumper years, the government says it has enough wheat and rice in store to prevent serious food-grain price inflation. With agriculture accounting for only 18% of GDP, compared with 30% in 1990, the drought will in fact cause relatively little damage to India's economy; it should still grow by over 5% this year. Lavish spending on rural welfare since 2004, when the Congress party won power in Delhi, will also help. Almost 30m people have benefited from the government's chief public-works project, the National Rural Employment Guarantee Scheme (NREGS).

Yet the drought underlines a grim truth. India's extremes of hydrology, poverty and population present vast difficulties for water management which it has never mastered. And they are growing. Increasingly frequent droughts may be a sign of this—if, as some think, climate change is to blame. It will accentuate India's problems, with the monsoon rains, which supply over 50% of much of India's annual precipitation in just 15 days, predicted to become even more contracted and unpredictable. At the same time, the rapid melting of Himalayan glaciers promises to deprive the great rivers of the Indian sub-continent, the Indus, Ganges and Brahmaputra, of their summertime source. This threatens a triple whammy: of longer dry seasons, in which these rivers do not flow, and more violent wet seasons. That would mean more bad news for flood-prone eastern India, including Bihar, where over 3m were displaced last year when the Kosi river burst a crumbling embankment.

India's water future was worrying even without climate change. Despite daunting seasonal and regional variations, it should have ample water for agricultural, industrial and household use. But most of it falls, in a remarkably short time, in the wrong places. India's vast task is therefore to trap and store enough water; to channel it to where it is most needed; and, above all, to use it there as efficiently as possible. And on all three counts, India fares badly. Without huge improvements, according to a decade-old official estimate, by 2050, when its population will be a shade under 1.7 billion, India will run short of water.

There are already signs of the conflict this would cause. Having bickered for decades over their rights to the Krishna river, AP and upstream Maharashtra and Karnataka are now furiously building dams and diversions that the river might not support even in flood. In Orissa 30,000 farmers—for whom over 80% of India's water is reserved—laid siege to a reservoir in 2007 to try to stop factories using its waters. The desert state of Rajasthan has seen similar protests against the diversion of water to its growing cities. In one, five farmers were shot dead by police.

The government is worried: "2050 is a very frightening sort of a picture," says A.K. Bajaj, chairman of India's central water commission, which provides technical support to the state governments who control India's water. Its main solution is to build more large dams (390 are under construction), and river diversions, including a long-mooted extravaganza of 30 linkages which would unite most of India's river basins. Indeed, India needs more water storage: it has 200 cubic metres per person, compared with 1,000 cubic metres in China. But given the decrepitude of much of its existing water infrastructure, and its profligate ways with water, its more urgent priorities are to repair and reform.

Worshipping old gods

Famine-prone for most of its history, India's attachment to dams is understandable. Its ability to feed itself owes much to a splurge on big dams and canal projects in the 1950s-70s—for example, the colossal Bhakra dam in Himachal Pradesh, completed in 1963 and described by the then prime minister, Jawaharlal Nehru, as a "new temple" of India. The Bhakra brought 7m hectares of north-west India, chiefly Punjab and Haryana, under irrigation. This prepared the way for the Green Revolution of the 1960s, when the introduction of new seeds and chemical fertilisers hugely boosted farm yields in those states and in the coastal region of AP—which was irrigated in the 19th century by a British engineer, Sir Arthur Cotton, who is still worshipped there as a god.

But, the world over, without expensive maintenance to prevent siltation in reservoirs and leakage from canals, grand dams and irrigation schemes tend to be as inefficient as they are environmentally destructive. And India's corrupt, underfunded and overmanned state irrigation departments—UP's, for example, employs over 100,000 people—often provide no maintenance at all. As a result, each year India is estimated to lose the equivalent of two-thirds of the new storage it builds to siltation. Bad planning, often as a result of inter-state rivalries, causes more waste. Thus, between 1992 and 2004 India built 200 large and medium-sized irrigation projects—and the area irrigated by such schemes shrank by 3.2m hectares.

The village of Veeralapalam offers a snapshot of this, and of the losers in a political economy where water is the main currency.

From the early 1960s it received occasional water in a small canal, at the tail-end of a system off the Krishna river. But this has been dry since 1985 because of leakage up-channel and, the Lambadi farmers say, illegal tapping by members of a more favoured community. The canal was re-dug last year under the NREGS, but seems unlikely to get any water.

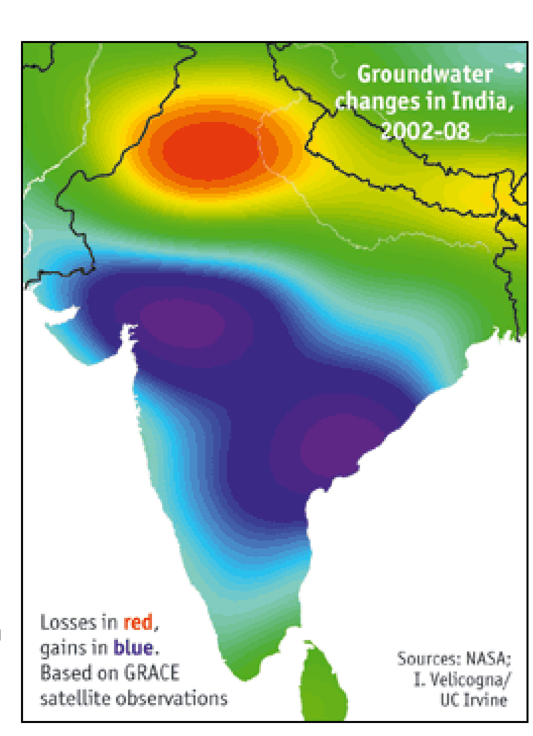
A few miles up-channel in Ulisaipalam, a village dominated by high-caste Hindus, there is water, but more problems. Wading shin-deep, P. Venkat Reddy transplants dark green paddy into his two acres of irrigated, but undrained, land. When there is water in the canal, for around four months each year, it is waterlogged, fit only for paddy. But in recent years the canal has held insufficient water for a full paddy crop—forcing Mr Reddy to supplement it with groundwater. He pumps this, with electricity given free to farmers in AP, from a borehole drilled 45 metres into his land.

Since the 1970s, when affordable water pumps became available and electricity reached many more places, millions have done the same. India is the world's biggest user of groundwater, with some 20m bore-holes providing water for over 60% of its irrigated area. Being entirely in farmers' hands, this is up to three times more productive than canal irrigation. In 2002, by a conservative estimate, it was worth $8 billion a year to the Indian economy—more than four times what the central and state governments spend on irrigation schemes.

Groundwater irrigation has transformed the lives of millions. It has also rectified problems, of water-logging and salination, caused by canals. But in many places, including productive Punjab and Haryana, whose rather well-off farmers also get free or cut-price electricity, the rate of groundwater extraction is unsustainable. Nearly a third of India's groundwater blocks were defined in 2004 as "critical, semi-critical or over-exploited". The World Bank reckons that 15% of India's food is produced by "mining"—or unrenewable extraction of—groundwater, including in 18 of Punjab's 20 districts. Satellite maps released by America's NASA last month showed that north-western India's aquifers had fallen by a foot a year between 2002 and 2008: a loss of 109 cubic km (26 cubic miles) of water, or three times the volume of America's biggest man-made reservoir.

This is storing up trouble. As bore-holes run dry, as those over the hardrock aquifers of southern-central India do on a monthly basis, many poor people may be deprived of safe drinking water. Currently, 220m Indians lack this. Not all India's groundwater is potable anyway; in places, it is getting seriously polluted. And India's groundwater reserves will be especially missed when climate change makes surface-water sources even more sporadic. Their depletion will accentuate this, with springs, which could have provided a trickle of run-off during the extended dry seasons, increasingly failing.

Pump and be damned



Some excuse this resolute destruction by saying that India's farmers do not understand groundwater. But they know when it is running out, as an impromptu conclave in the Punjabi village of Lubana Teku showed. "Punjab will become a desert, like Rajasthan," said Jarnail Singh, a stately, orange-turbaned grower of rice. When Mr Singh began pumping groundwater in 1973, turning his 14 acres from cotton to paddy, it took a three-horsepower engine to bring it up from 1.5 metres. Now the groundwater is 20 metres down, and he requires a 15-horsepower pump to sluice his green paddy-fields. "We know the water is going," said Mr Singh. "But we're not going to change our ways unless the government makes us."

Rather, it encourages him to keep pumping. Besides paying nothing for his water or electricity—seven hours of it a day—Mr Singh knows the government will buy all the rice he can grow, at a pre-ordained "minimum support price". Set against this package, Punjab's efforts to conserve its groundwater, mainly by telling farmers not to transplant paddy before the monsoon rains, are

rather puny.

State governments know that this is madness. Over a quarter of India’s electricity is given free or cut-price to farmers. As a result, the state power utilities are bust. Understandably, however, politicians balk at reform. Two chief ministers recently tried charging farmers for electricity, in AP and Madhya Pradesh, and were kicked out of office. The Congress party chief minister of Haryana, which is going to the polls in October, will not make that mistake. He is demanding $200m from India’s Congress-led central government as a contribution to Haryana’s agricultural-power subsidy.

The subsidy raj is not confined to farmers. Many municipal governments price water well below cost, and therefore struggle to supply it. Delhi, where the water board’s revenues cover only 40% of its operating costs, should have plenty of water. It draws 220 litres per citizen, more than Paris. But half of it disappears from leaky pipes. To mend these, workmen, having no underground maps, must dig up and sift through a tangled mass of pipes and cables, like untrained surgeons manhandling intestines.

Predictably, for a couple of hundred rupees a month, posh south Delhi gets the best water supply. When its taps run dry, the locals, including India’s political and bureaucratic elite, pump groundwater—often illegally. By one estimate, bore-holes provide 40% of the capital’s water; and south Delhi’s groundwater, which underlies the offices of India’s Central Groundwater Authority, is being depleted by up to three metres a year. But tube-wells, which cost around $600, are no option for Delhi’s poor, including 4m slum-dwellers. To augment their supply they must buy water, of dubious quality and at extortionate prices, from a well-connected water mafia.

In fiery June residents of Sangam Vihar, a poor suburb of south Delhi, rioted after getting no water for two weeks. In normal times, according to Vishnu Sharma, a 36-year-old resident, he and his family receive, at unpredictable times, around an hour and a half of muddy piped water each week. They pay $2 for this, he said—and another $20, or a quarter of his factory wage, to private water-sellers in cahoots with corrupt water-board officials. “So why bother complaining?” he said angrily.

Who could deny that rich Delhiites must pay more for water, so the city’s poor can get more? The rich, of course. In 2005 a World Bank-sponsored effort to reform the water board was shot down by local NGOs. As well as worrying, reasonably, about the bidding process for contracts, they were outraged to discover that, in return for round-the-clock clean water, the targeted households would be charged about $20 a month—or what Mr Sharma pays his local water don.

EPA



An increasingly precious load

Pay more, use less

To make farmers use less water, they must pay, or pay more, for electricity. The longer state governments wait to institute this, the higher the cost of pumping groundwater will go—and the more difficult reform becomes. Nor is pricing alone a panacea. According to a World Bank study, farmers are already paying rather a lot for subsidised but poor-quality electricity. In Haryana, farmers with electricity spent 25% of their incomes on it and on repairing burnt-out pump-engines; those without electricity spent 31% of their incomes on diesel. To charge farmers more for electricity, utilities will have to improve supply. And farmers must learn to use water more efficiently.

Selling groundwater to cities, as farmers outside Chennai have done, is one possible answer. Another, to keep up India’s food production, is to spread the use of modern seeds and other technologies—such as an improved system of paddy cultivation that uses half as much water and has boosted yields in Tamil Nadu and AP. Ideally, commercial cultivation of thirsty sugar-cane and paddy should also be shifted eastwards, to the poor and sodden parts of Bihar and West Bengal. For now, alas, the political trade-offs and mammoth infrastructure development this would require make it seem unimaginable.

Farmers on arid, rain-fed land need help of other sorts. Even if they had electricity—which 400m Indians do not—they could hardly pay for it. Nor would it be altogether desirable for them to pump groundwater unless they could be enjoined to sow appropriate crops, such as pulses and millet, and water them wisely. In dry areas, where profligate water-use by one farmer can make many wells run dry, farmers have been persuaded to share information on rainfall, groundwater levels and cropping, and so collectively regulate

themselves. One attempt at this in central AP involves 25,000 farmers.

And India must have more dams. These need not be large; indeed, given problems of maintenance and resettlement, it would be better if they were not. For these and other reasons, most experts also seem to want the ambitious river-basin-linkage idea to be scrapped. In most places, urban and rural, India’s state governments would do better to concentrate on building and restoring millions of small water storages, tanks and mini-reservoirs, and put local governments in charge of them. There is no simple solution to India’s complicated water crisis. But if prayers are necessary, let them be offered in small shrines, not vast concrete temples.

The president weighs in on health reform

Fired up and ready to go

Sep 10th 2009 | NEW YORK
From The Economist print edition

As Congress returns to work, two big bills before it may determine the fate of Barack Obama's presidency—and he knows it. First, health care

AFP



"THE time for bickering is over. Now is the time for action." With those fiery words, delivered to a special joint session of Congress on September 9th, Barack Obama made his case for reforming America's troubled health system. Coming after a legislative recess in which his efforts were demonised at town hall meetings across the country, this speech was widely seen as his best, and perhaps last, chance to rescue his most important domestic policy initiative from failure.

The speech was a success on several measures. It was passionate, which is essential if he is to win over a sceptical American public and energise his liberal base. Mr Obama has seemed professorial, even pedantic, during recent town hall meetings on health reform. This week, though, he seemed to have fire in his belly. For weeks, right-wing critics have made nonsensical but alarming claims that his reforms will lead to "death panels" and other travesties. Mr Obama's efforts to deflect such attacks by taking the high road have left many on the left cold, and confused the general public. In his speech, he denounced the right's "bogus claims" bluntly, insisting that such talk was "laughable if it weren't so cynical and irresponsible. It is a lie, plain and simple."

The most powerful part of his speech was his invocation of Senator Edward Kennedy, the liberal giant who had championed health reform for decades before he died last month. Reading from a letter he had received from him posthumously, as his widow listened from the gallery, Mr Obama made the moral case for change: "At stake are not just the details of policy, but fundamental principles of social justice and the character of our country."

During this passage, he cleverly reminded Americans that leading Republicans currently hostile to Democratic efforts at health reform—including Senators Orrin Hatch and John McCain—had worked hand-in-hand with Mr Kennedy on earlier, smaller efforts at health reform. That points to the second reason to think that Mr Obama's speech may yet succeed in kick-starting reform this autumn: it managed to position the president as a reasonable and moderate adult in a room full of petty and partisan ideologues.

The Republicans did not help their cause with their behaviour during his speech. Some, including their whip in the House, were caught fiddling with their BlackBerrys. Others rudely waved hand-made signs or copies of Republican health bills. And one, from South Carolina, even shouted out "You lie!" when Mr Obama insisted that his reforms would not cover illegal immigrants. (He later apologised.)

The speech positioned Mr Obama as a moderate in style and substance. He pointed out that while some on the left are demanding a single-payer system and some on the right want to abolish the system of employer-provided insurance, he considers both options too radical. He also announced a surprising idea to use executive authority to encourage state-level experiments in curbing malpractice abuses.

Mr Obama also unveiled the main elements of his own centrist reform plan for the first time. He wants to expand coverage to some 30m Americans without insurance, principally by introducing an individual mandate for cover, insurance exchanges, subsidies for the less well-off and heavy regulation of insurers. He also accepted an important proposal to tax the most lavish of insurance plans.

Crucially, he made it plain that he would not accept a health-reform bill from Congress that raises the deficit—not now, not ever. He also vowed that most of the $900 billion his plan will cost—again, the first time he has given a firm figure for his initiative—will come not from taxes on the rich, as the current bills in the House envision, but from internal savings to be realised within the health system.

He offers two reasons to suppose that this claim is not complete bunk. The first is the White House's support for empowering an independent panel of experts to cut costs in Medicare and other government health schemes. This matters, because Congress has shown it is incapable of making such difficult cuts. More impressive is his vow this week that any final bill must include provisions for mandatory spending cuts that would kick in if budgeted cost savings do not materialise.

Will this speech be enough to get the president's reform agenda back on track? It just might be. One reason to think so is the deft way Mr Obama signalled a willingness to compromise on the "public option" this week. The left has insisted on a government-run insurance scheme, but this ill-founded idea is strongly opposed by the health-care industry and by Republicans. It also has no hope of passing the Senate, as Max Baucus, the head of its Finance Committee, confirmed this week. Mr Obama voiced theoretical support for the idea, but by also supporting other options—including, crucially, the idea that such a plan could be triggered only if necessary later—he has, in effect, dealt it a death blow.

Several committees in the House have already passed versions of health bills, but all contain the public option and are seen as too far to the left of the Senate—and now, it is clear, of where Mr Obama stands. So all eyes are now on the Senate Finance Committee, where a "Gang of Six" led by Mr Baucus has been working to forge a moderate bill that could provide the backbone for any final health law this year. Mr Baucus this week unveiled his own $900 billion proposal (also a moderate approach without the public option), and announced plans to finalise a bill next week.

Earlier this week that effort seemed to be flagging, as two of the Republicans in the gang, Charles Grassley and Mike Enzi, appeared to be undermining its efforts. That leaves Olympia Snowe, the free-spirited Republican from Maine, as the most courted legislator in recent memory. Mr Obama's speech and sensible proposals, which are similar to those drafted by Mr Baucus, and his openness to the trigger option favoured by Ms Snowe, can only boost efforts at compromise.

Whether it is enough to keep Ms Snowe and perhaps one or two other Republicans firmly on board remains to be seen. But even if it does not, the next few weeks could yet produce a bill that is better than anything seen thus far and which would be worth passing. He was not the first president, Mr Obama said, to take up health-care reform; but he was determined to be the last.

The cap-and-trade bill

Waiting for the other shoe to drop

Sep 10th 2009 | NEW YORK AND HOUSTON
From The Economist print edition

The second big bill before Congress is also in difficulties

Alamy



In need of some restraint

COMPARED with the argy-bargy over health-care reform, this summer's public conversation about controlling carbon emissions has been a model of restraint. In August, a Zogby poll commissioned by the National Wildlife Federation found that 71% of likely voters in America support the Waxman-Markey bill, a proposal to create a cap-and-trade mechanism for carbon dioxide that cleared the House of Representatives in June. But the bill still faces an uphill climb in the Senate, which resumed work on September 8th.

The bill's future is clouded partly because health care consumes virtually all Barack Obama's political capital, and partly because Republicans, whatever the polls may say, think cap-and-trade is a political loser for Democrats. When public attention swings to the issue, they can paint it as a stealth tax on energy—and during a recession at that. Republicans who were formerly committed to climate legislation include John McCain, last year's presidential nominee, as well as Lisa Murkowski of Alaska and Richard Lugar of Indiana, a centrist and internationalist who appreciates the importance of climate change to global opinion. All have disengaged from the negotiations.

As they do so, protests—though nothing like as rowdy as those over health care—have begun. The largest have come from a group called Energy Citizens, which has sponsored rallies in a handful of cities around the country. As the campaign is backed by the American Petroleum Institute, these events have a whiff of corporate manipulation. Still, many voters are not faking their concern. At the kickoff rally in Houston several thousand people gathered peacefully to listen to speeches and eat hamburgers.

Back in the Senate, fear that cap-and-trade will be painted as a murky, confusing job-killer and a bureaucratic hassle makes Democrats in conservative states nervous. They include Ben Nelson of Nebraska, Louisiana's Mary Landrieu and both senators from North Dakota. Head counts fall far short of the 60 votes required to ensure passage.

The gamut of committees that the bill must pass in the Senate may yet save it, though probably at a hefty price. Barbara Boxer, the chairman of the environment committee, plans to submit her version of the bill later in September. Her starting point may be the bill that passed the House energy committee, a greener bill than the one that passed the full House. This was weakened by concessions to farmers and other giveaways at the last hurdle in order to secure House passage.

Then the Senate committees can set about adding pork. The Senate (with two members per state, no matter how empty) represents agriculture more heavily than the House. Paul Bledsoe of the National Commission on Energy Policy reckons that extra incentives to farmers, at first pared back from House bill levels, may be added in higher amounts later in the process to help bring Senate moderates on board. (Tom Vilsack, the agriculture secretary, has been busily promoting action on climate as a way of boosting farm incomes, since farmers can earn "offsets" from polluting industries by reducing their own greenhouse-gas emissions.) More support for nuclear power (nearly emissions-free, but controversial) could bring back a few centrist Republicans. Attention to natural gas—nearly absent from the House bill, but produced in 32 states—could help as well.

Environmentalists have problems with the House bill's concessions to coal and other special interests. But most of the main interest groups support it, including the Sierra Club, the Environmental Defence Fund and the World Wildlife Fund. Greenpeace is a notable exception. Phil Radford, the group's executive director, says with disappointment that "You have the president really hiding behind Congress." He

complains that Mr Obama has sacrificed his vision to conservative "Blue Dog" Democrats, and that it would be better the other way around.

Joe Romm, a senior fellow at the Democrat-leaning Centre for American Progress, says that while the bill has its limitations, "Obama can't pass a substantially stronger bill than Waxman-Markey. It's not possible." He notes that after Bill Clinton's health-care reform fell apart it took 16 years to revisit the issue. Climate-change purists should bear in mind the consequences of failure. "If this bill goes down," he says, "it will be a very long time before we come back to it. [And] I don't see how the international process survives."

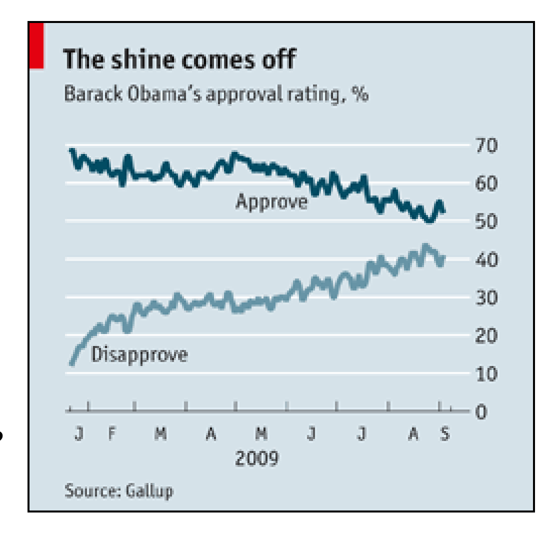
Barack Obama's falling ratings

The summer of waning love

Sep 10th 2009 | WASHINGTON, DC
From The Economist print edition

Of polls and presidents

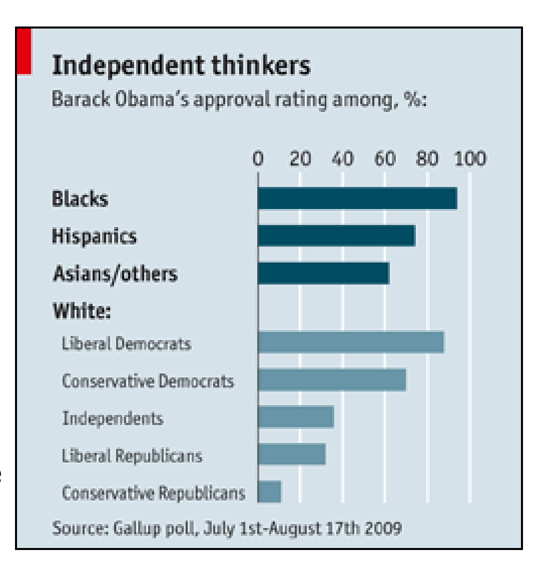
ONCE upon a time—ie, a few months ago—Barack Obama was the hip new president with the cool manner, who made no mistakes and enjoyed the approval of a majority of voters. Today the president is still cool: his big speech on health reform this week was delivered with his signature mix of passion and intelligence. But he has come close to losing that majority. His job-approval rating has fallen to 51% after eight months in office. If he dips below 50% before November, says Gallup, Mr Obama will have reached that point in near-record time, falling faster in public opinion than any post-war presidents bar Gerald Ford and Bill Clinton.



What has Mr Obama done to deserve this summer of waning love? Democrats wail that a right-wing fringe is determined to delegitimise the president and that the media has amplified its voice. How else could panic about fictitious "death panels" drown out rational debate about health reform? News that Mr Obama was to give a talk to the nation's children generated cries of "indoctrination"—until the speech, on September 8th, turned out to be a schoolmasterly homily in favour of hard work.

And yet the polls suggest that Mr Obama's trouble is not only with the right. Writing in the *National Journal*, Charlie Cook, a respected analyst, has observed that independent voters are deserting Mr Obama fastest. In recent weeks this segment of the population has been giving Mr Obama an approval rating in the mid- to high 40s, down from the 60-70% that prevailed from mid-April to early June. The loss of these weathervane voters, said Mr Cook, should "terrify" the Democrats as they look ahead to the mid-term elections in only 14 months' time.

This may be too alarmist. Frank Newport, the editor-in-chief of the Gallup Poll, notes that most presidents lose popularity after their election. Mr Obama's rating among all voters has fallen (see chart) but remains close to the historical average of 55%. As for independents wavering most, unattached voters are naturally more fickle than loyalists. And the number of true independents is smaller than it seems. About a third of voters say they support neither main party, but the proportion falls to about 10-12% after subtracting those who admit to "leaning" towards one party or the other.



The first year is anyway a lousy guide to presidential fortunes. Ronald Reagan and Mr Clinton also faced big economic difficulties early in their terms. Unlike Mr Obama's (so far), their ratings fell through the 40s, yet both were re-elected to second terms. George Bush senior was highly popular through his first year and became more so after the Gulf war of 1991. But voters slung him out after a single term.

All that said, the wavering of independents is bound to worry Democrats facing mid-term elections next year. An abrupt change in the opinion of 10-12% of the electorate can in principle have big consequences, says William Galston, a senior fellow at the Brookings Institution in Washington. But he, for one, is struck by a similarity between Mr Obama's troubles and those of Reagan in 1981.

Reagan, too, inherited an economic crisis that did not respond rapidly to corrective action. In 1982 the Republicans went into the mid-terms with unemployment above 10% and a president whose approval rating languished in the 40s. Yet the expected electoral calamity failed fully to materialise: the Republicans held their own in the Senate while losing 26 seats in the House, less than had been feared.

Might a similar pattern help the Democrats next year? Perhaps: but few Democrats now in office hark back to the Reagan precedent. More are fixated on their own party's fate in the mid-terms of 1994, when the Republicans stormed back and recaptured the House. A lot are sure that the cause of that debacle was the failure of Bill and Hillary Clinton to pass health reform, and that coming up empty again could prove calamitous this time, too.

But it is also arguable that the Democrats' big problem 15 years ago was not the failure on health care but the perception that the party had moved too far left. And that could happen again. On September 5th Van Jones, a White House adviser on green jobs, was forced to resign after it emerged that he had once signed a petition accusing the Bush administration of knowing in advance about September 11th 2001 but doing nothing in order to furnish a pretext for a war. Just a lapse in vetting, said the White House. But grist to the mill of all those telling voters that the cool Mr Obama presides over a government of big-spending wild-eyed radicals bent on nationalising health care.

The trouble with pornography

Hard times

Sep 10th 2009 | LOS ANGELES
From The Economist print edition

A big industry in northern Los Angeles is among the worst hit by the recession

AFP



EVEN Nina Hartley, who became a pornographic actress in 1984 and continues to be one of its most sought-after performers at the age of 50, is feeling the recession. "Last year I did a scene a week, this year I do a scene a month," she says. As a sex celebrity, she has not dropped her fees, charging about $1,200 for a "straight boy-girl" scene. But production has collapsed, and for younger performers so have prices.

The adult-film industry is concentrated in the San Fernando Valley—"the Valley" to Angelenos—on the northern edge of Los Angeles, so the slump in porn is yet another factor depressing the local economy. Pornography had been immune to previous recessions, so the current downturn has come as a shock.

Most of the industry consists of small private production companies whose numbers are secret, but Mark Kernes, an editor at *Adult Video News*, a trade magazine, estimates that the American industry had some $6 billion in revenues in 2007, before the recession, mostly in DVD sales and rentals and some in internet subscriptions. Diane Duke, the director of the Free Speech Coalition, the adult industry's trade group, thinks that revenues have fallen 30-50% during the past year. "One producer told me his revenue was down 80%," she says.

If the Valley used to make 5,000-6,000 films a year, says Mr Kernes, it now makes perhaps 3,000-4,000. Some firms have shut down, others are consolidating or scraping by. For the 1,200 active performers in the Valley this means less action and more hardship. A young woman without Ms Hartley's name-recognition might have charged $1,000 for a straight scene before the crisis, but gets $800 or less now. Men are worse hit. If they averaged $500 for a straight scene in 2007, they are now lucky to get $300. For every performer there are several people in support, from sound-tech to catering and (yes) wardrobe, says Ms Duke, so the overall effect on the Valley economy is large.

The recession, moreover, has exacerbated a previous crisis. Piracy is the main problem. And the internet, with its copious free clips, is an increasingly viable alternative to the paid stuff. Pornography in general has become "like potato chips, everywhere and cheap, to be consumed and tossed," says Ms Hartley. It's not the same as in the golden age when she joined. "The industry will shrink and stay shrunken," she reckons.

Off-track betting in crisis

Flogging a dead horse

Sep 10th 2009 | NEW YORK
From The Economist print edition

Will No 9 prove a winner?

DESPITE its offputtingly seedy appearance, the Off-Track Betting (OTB) parlour in Queens was packed. Some of the punters looked as if they were down on their luck. All eyes were on the many television monitors where horse races were being broadcast. More were outside, smoking, and peering in through the window to see if their horse had come in. But despite doing healthy business, New York City's Off-Track Betting Corporation, a quasi-public bookie, is practically skint. The OTB takes in $1 billion-worth of bets each year, yet it is running a structural deficit of almost $600,000 a month and has been operating in the red for years; it could be broke by next March. So on September 1st David Paterson, New York's governor, announced that the OTB will soon file for protection under Chapter 9 of the federal bankruptcy code.

The OTB, the city's only legal bookie, was created in 1970, in part to take gambling out of the hands of organised crime by providing a legitimate outlet for betting on horses. It was also intended to be a moneymaker for city and state, and for a time it was. It made $4.5 billion for the two governments' coffers, but betting on horse races has become stagnant and is a rapidly shrinking segment of the overall gambling market. "Public interest in horse-racing in New York state has simply shrivelled up," says Bennett Liebman, who heads a racing think-tank at Albany Law School. New York state's total revenue from racing (from tracks and OTBs) is now barely a quarter of what it was 30 years ago.

Most of the dwindling takings are used to pay off winning bets. The remaining money is first disbursed to the city and to New York state, and another large chunk ends up in the racing industry's coffers, before the OTB itself gets a look-in. As a result, the OTB was left with an operating deficit of $17.8m for 2008. Michael Bloomberg, New York City's business-minded mayor, wanted to close down the operation, but in the end allowed a state takeover last year. The state comptroller's recent OTB audit observed that the horse industry is too important to the state to fail. There are 500 horse-breeding farms in New York state, and some 40,000 New Yorkers rely on the industry for employment. But the audit concluded that even if cost-savings are implemented, the OTB is unlikely to remain solvent for long.

Sandy Frucher, the newly appointed head of New York City's OTB, disagrees. He believes that it can be saved by overhauling the outfit's business model and upgrading its technology. He envisions fewer branches (there are currently 57 in the city) but more chances to have a flutter such as via a personal computer and through ATM-style video kiosks in bars and lottery shops. Renegotiating union contracts could also save a bob or two. The OTB may not alter its business model or its statutory funding formula until it files for Chapter 9, but once it is under protection it can do both those things. The restructuring plan will reportedly include the sale of bonds to pay off some debts. And the filing will not halt operations.

In France, Mr Frucher's exemplar, a strong marketing campaign has glamorised the former sport of kings. It transformed the sport's clientele; today one in three of those who bet on racing there is under 35 and more than 40% are female. Australian racing, meanwhile, has expanded its footprint by bringing betting into pubs. Mr Frucher can see a time where the OTB "can go head-to-head with pornography" as a source of entertainment. He did not offer odds on this prediction.

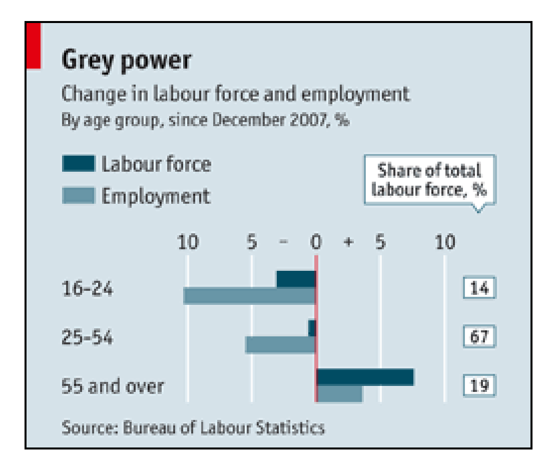
Older workers and the recession

Still good for a few more years

Sep 10th 2009 | WASHINGTON, DC
From The Economist print edition

Smaller nest-eggs enhance a long-term trend to later retirement

IN TERMS of output, America's recession may be showing signs of ending; but it retains its painful grip on the labour market. Non-farm employment fell in August by the smallest amount in a year in absolute terms (though by a still-horrid 216,000); but the unemployment rate nevertheless rose, to 9.7%. That is up almost five percentage points since the recession began in December 2007.



One group, however, is so far looking a bit less gloomy. The number of people aged 55 and over who are in work has climbed almost 4%, or by nearly 1m, since the recession started, even as employment of young and middle-aged workers has fallen sharply (see chart). Gains have been even greater for those over 65, the usual retirement age. Why?

Older workers tend to do better in recessions. They have skills, experience and seniority, and are thus last to be sacked. But this does not explain much of the rise in employment; in fact the unemployment rate of those over 55 has actually risen too, though by less than the average.

Something else is going on. The labour force of over-55s—those either working or looking for work—has grown briskly since the recession began, by almost 8%. Some of this is due to an ageing population and some to a rising share of that population in the labour force: the so-called participation rate has jumped a percentage point, to 40%, while slipping for the population as a whole. In other words, higher employment of over-55s reflects not just relatively stronger demand, but more supply.

The most common explanation is that shattered stock and house values have forced many workers to delay retirement so as to rebuild their nest eggs. The importance of this factor is a matter of debate. A Federal Reserve study in 2003 concluded that for each $100,000 in unexpected gains in the 1990s, the typical shareholder retired seven months earlier. But a later one by Courtney Coile and Phillip Levine, both of Wellesley College, found that the stockmarket boom in the 1990s and its subsequent bust had no measurable impact on overall labour supply. They concluded that it did influence the retirement decisions of some workers, but most either had too little invested in the market to be affected or were wealthy enough not to care.

Karen Dynan, co-director of economic studies at the Brookings Institution, thinks the effect may be bigger this time round because of the decline in the value of houses, which for most families are a larger source of wealth than stocks. She calculates that for over-55s, median wealth fell from 5.7 times income in 2007 to 4.6 in 2008, returning to the level of 1995.

But while diminished wealth may keep more of the elderly in the office, it merely enhances an underlying trend towards later retirement. Joseph Quinn, an economist at Boston College, notes that workforce-participation rates for older male workers fell steadily from the late 19th century until the mid-1980s, then gradually began to turn up, while for women at that time they began to rise. He attributes this to several factors: the abolition of mandatory retirement in 1986, changes to the government pension that raised benefits for those retiring after 65, and the decline in defined-contribution plans which penalised late retirement in financial terms.

Furthermore, work has become less physically arduous and more pleasant and people tend to stay healthier in old age; so more people are either able or willing to work longer. A poll by the Pew Research Centre, released on September 3rd, found that 54% of those working over the age of 65 do so because they want to; just 17% do so because they need the money.

In the short term this is a problem. Younger workers are having a harder time finding and keeping a job because older workers won't clean out their desks. But in the long term later retirement counters the trend to slowing labour force growth caused by an ageing population, more years spent in college, and a levelling out of women's participation. So it boosts the economy's potential growth rate. And as a side-effect, it should ease the task of paying the health bills of all those older people.

Black cowboys

Urban rodeo

Sep 10th 2009 | HOWARD BEACH, NEW YORK
From The Economist print edition

Riding New York City's asphalt range

Eyevine



Where the buffaloes don't roam

ON ONE hot recent morning half a dozen white geese paddled in a babbling stream, which flowed underneath low-hanging trees. Nearby a ranch hand washed down a dusty horse. Two men in jeans, cowboy boots and wide-brimmed Stetsons looked on as they tried to stay cool in the shadow of a barn. Meanwhile, George "Bubba" Williams practised his rope tricks. This sounds like a scene straight out of the Old West, but Cedar Lane Stables is 2,000 miles away, in the Old East, namely New York City's Howard Beach. It is run by the Federation of Black Cowboys.

The federation, a non-profit group, was founded in 1994 and has about 30 members, almost all of them with nicknames, like "the Arkansas Kid" and "Saddle Tramp". Unlike other riding groups, its main mission is to promote the role the forgotten black cowboy played in America's history. "A third of all cowboys were African-American," claims Eric "Little Red" Jackson, a federation board member, "but most people think cowboys look like Clint Eastwood or John Wayne." School and youth groups visit to learn about the unsung black heroes of the old West, such as Stagecoach Mary, a former slave and post-carrier, Bill Pickett, who invented "bulldogging" (a rodeo technique), and the Buffalo Soldiers, the acclaimed black infantry and cavalry regiments.

Inner-city children from neighbouring East New York, a rough section of Brooklyn where real gunslingers still roam, come to the stables to learn to ride. Warren "Black Red" Small, the foundation's co-founder and proud cowpoke, says by learning how to take care of a horse, "the kids pick up some horse-sense." The federation occasionally hosts rodeos and barbecues. Although the stables' picket-fenced 26 acres (10.5 hectares) is picturesque in parts, it is mostly ramshackle and down-at-heel. The federation has ambitious plans to build a museum, but barely has the funds for basic upkeep, much less new buildings. Some of the stable's 40 or so horses are housed in converted shipping containers.

Howard Beach is a predominantly white neighbourhood that is perhaps best known for a 1986 racial incident, where a gang of white teens caused the death of a black man. Ed Koch, who was then New York's mayor, compared the death to a lynching. The cowboys say they have had no racial problems and get on well with their neighbours. The only complaints in recent years have been that the roosters are too loud.



Lexington

Free speech for me, but not for thee

Sep 10th 2009
From The Economist print edition

The Supreme Court ponders whether speech curbs are constitutional

Illustration by KAL



"HILLARY: THE MOVIE" is unwatchable. From the first frame, it presents a dreary caricature of Hillary Clinton as a power-crazed harpy with no redeeming qualities. She is cynical, manipulative, dishonest and ruthless—and so on for 90 excruciating minutes. Wasn't there at least a dog she once omitted to kick, or a child whose lollipop she didn't steal?

That said, "Hillary: the Movie" is no duller or more biased than much of what passes for journalism these days. And it is clearly political speech, which the constitution's first amendment unambiguously protects. "Congress shall make no law… abridging the freedom of speech," it says. Not "thoughtful, balanced speech"; just "speech". Yet the creators of the movie were forced to drop plans to distribute it via cable television for fear of stiff fines and long jail terms.

The reason is that Congress has in fact passed a number of laws that abridge the freedom of certain groups to say certain things, in certain ways and at certain times about—wait for it—politicians. Among these laws is the Bipartisan Campaign Reform Act of 2002, better known as McCain-Feingold after its senatorial sponsors. Among other things, this law bars corporations or unions from financing the broadcast of electioneering messages about candidates within 30 days before a primary or 60 days before a general election.

The Hillary movie was made by a conservative group called Citizens United, which wanted to release it during the Democratic primaries last year. The group calls its creation a documentary, which would be exempt from McCain-Feingold's strictures. The Federal Election Commission (FEC) ruled it was the equivalent of an attack ad, and could therefore not be paid for with money from for-profit corporations. Citizens United is a not-for-profit group supported mostly by individual donations, but it has also received donations from private firms. It sued the FEC on free-speech grounds, and the case came before the Supreme Court earlier this year. Instead of deciding it on narrow grounds, the court took the unusual step of asking for it to be re-argued, to examine the constitutionality of a large part of America's campaign-finance system. It heard arguments on September 9th.

The case for campaign-finance curbs goes something like this. Corporations have a lot of money, which could give them a lot of influence. So they should be barred not only from giving large amounts to candidates but also from paying to disseminate views that might affect an election. If they wish to raise

money to express political views around election time, they must form a "political action committee" (PAC), jump through regulatory hoops and raise only limited amounts of money from each donor. The counter-argument is that this system (which is much more complicated than described) does not work. It has not kept money out of politics: the amount spent on presidential elections has grown relentlessly. And the complexity of campaign-finance law makes it hard even for well-meaning candidates to be sure they are not breaking it. John McCain, who ought to know better, was accused of an arcane but serious violation last year.

Big companies can hire lawyers to help their PACs find their way through the maze, but the little guys get lost. And some states have tried to use campaign-finance laws to stifle debate. In Washington state, prosecutors claimed that a friendly discussion of an anti-tax campaign on a radio show was a political donation that the campaigners should have declared. In Colorado, a group of homeowners protesting a plan to incorporate their neighbourhood into a nearby town were sued for displaying yard signs without registering as a PAC. Free-speech advocates won these cases, but they needed lawyers to do so.

Another effect of campaign-finance laws is to protect incumbents. That, suggested Justice Antonin Scalia on September 9th, may well have been their purpose. Incumbents have no trouble getting on the evening news. Their challengers are often unknown, and making it harder for them to raise money increases the odds they will stay that way. Outsiders can sometimes break in, as Barack Obama spectacularly showed. But the big donations that jump-started the insurgency of Eugene McCarthy, the anti-war candidate who prompted Lyndon Johnson not to seek re-election in 1968, would be illegal today.

Newspapers and television stations are exempt from the strictures of McCain-Feingold, so they can spend vast sums supporting or hounding political candidates without fear of reprisal. Some media firms, such as the *New York Times*, see no problem with denying other corporations the same right. But five of the nine Supreme Court justices seem to find it troubling. If a politician promises to ban tobacco, asked Chief Justice John Roberts this week, is it fair to ban tobacco firms from responding?

And now to books

Free-speech enthusiasts fear that unless the first amendment is jealously guarded, it will be abused. And they have reasons to do so. Earlier this year the federal government claimed the power to ban books that support or oppose a named candidate, if those books are financed by a corporation, as most books are, and published too close to an election. That could include anything from Michael Moore's rantings to John Kerry's ponderous autobiography. This week, the solicitor-general appeared to retreat from this outrageous claim, saying that the FEC almost certainly would not ban books. But what about pamphlets? And why should something so fundamental depend on a bureaucrat's whim? With bloggers and YouTube continually blurring the line between advocacy and journalism, it is growing ever harder to regulate corporate speech coherently. The Court may well tell politicians to stop trying.

Economist.com/blogs/lexington

Correction: Gambling in Florida

Sep 10th 2009
From The Economist print edition

Our piece on the compact between the state of Florida and the Seminole tribe (September 5th) wrongly stated that the Seminole were running slot machines and blackjack games illegally. These "Class III" games, though illegal everywhere in Florida under state law, were exempted for the Seminole by a compact with the governor of November 2007. Although this compact has since been nullified by the legislature, it was approved by the federal Department of Interior in January 2008 and that approval has not been rescinded. The Seminole, therefore, have been and are in full compliance with federal law.

Mexico's embattled president

Calderón tries again

Sep 10th 2009 | MEXICO CITY
From The Economist print edition

Assailed by difficulties, Mexico's president is demanding radical reforms just when his power to achieve them has diminished

Illustration by Claudio Munoz



IF MEXICO'S president recognises that his conservative National Action Party (PAN) was crushed in a mid-term election two months ago, there was little in his annual report to Congress on September 2nd to suggest it. Setting out an ambitious agenda for the remainder of his six-year term, Felipe Calderón called for ten reforms, including action on politically controversial matters such as labour laws and telecommunications regulation. Mexico had to overcome the constraints imposed by partisan political calculation, he said, and embrace "fundamental changes" to break "inertias". Days later he himself illustrated how hard this will be with a cabinet shuffle, including the firing of the powerful attorney-general, which seemed to create as many problems as it solved.

If crisis were indeed opportunity, Mr Calderón would have enviable scope to act. Taking office in December 2006 with a narrow mandate after a disputed election, he launched the army against violent drug-trafficking gangs. Despite the government's repeated assurances that it is turning a corner in its battle against organised crime, the violence continues. Increasingly, its victims are politicians: on September 6th, a legislative candidate in Tabasco state was murdered, along with his wife and children. Battered by recession in the United States, the economy is set to shrink by up to 7% this year. The pace of decline is slowing—GDP contracted by 1.1% in the second quarter of 2009, compared with 5.9% in the first. But unemployment has soared to 6%, while a further 13% of the labour force is underemployed. An outbreak of swine flu in April has receded, but not before wreaking havoc on the tourist industry. Oil output is plunging because of the inefficiencies of Pemex, the giant state oil monopoly.

Before the mid-term election, the PAN was the largest party in Congress, though lacking a majority. Mr Calderón settled for only modest reforms, of energy, education, pensions and the public finances. Now his ambition has grown but his power has waned. The Institutional Revolutionary Party (PRI), which ruled Mexico for seven decades until 2000, regained a congressional majority (with a small allied party) in the midterm election. With only 143 of the 500 seats in the lower house, the PAN cannot even sustain a presidential veto.

Mr Calderón is not yet a lame duck: a poll this month gave him an approval rating of close to 70%. The

cabinet changes seemed aimed at cementing his own authority. Eduardo Medina Mora, the sacked attorney-general, was a former businessman and a powerful and independent figure. Though damaged when one of his senior lieutenants was accused of corruption last year, his conduct of the fight against the drug gangs had gained the confidence of the United States. But he had clashed repeatedly with Genaro García Luna, the public safety minister, a former policeman and Calderón loyalist.

The new attorney-general, Arturo Chávez, is a PAN loyalist who, as chief prosecutor of the northern state of Chihuahua, was criticised by human-rights groups for failing to investigate properly the murders of hundreds of women in Ciudad Juárez. His promotion looks ill-judged, given that many in the United States Congress want tougher human-rights conditions attached to American anti-drug aid to Mexico. But Mr Calderón appears to want to centralise security policy in his own office.

The other big change is at Pemex. Its chief executive, Jesús Reyes Heroles, a former PRI minister, has been replaced by Juan José Suárez Coppel, who has a private-sector background but also has ties to a different PRI faction. His appointment suggests that Mr Calderón will try to stretch the limited scope for private investment in oil contemplated by the energy reform.

But his first battle will be over the 2010 budget. Tax revenues have plunged, jeopardising Mexico's investment-grade credit rating. At the same time, recession has increased the demand for social spending. The draft budget announced this week involves a careful balance. It includes a temporary rise in income tax from 28% to 30% for the highest earners, a new 2% sales tax and a tax on telephones. Public spending will fall by 1.8% of GDP, with three ministries scrapped and other austerity measures. But the government wants to raise spending on Oportunidades, its targeted anti-poverty programme, and on achieving universal health care. All this would trim the budget deficit to 0.5% of GDP, from around 2% this year.

The fate of this budget, along with much of the rest of Mr Calderón's agenda, now lies with the PRI. Ideologically amorphous, the party's priority is to win back the presidency in 2012. That requires walking a political tightrope. Unconditional support for Mr Calderón's programme would both strengthen the president and burden the PRI with the cost of unpopular reforms. But uniform opposition would expose the party to the charge of putting partisan advantage ahead of the national interest at a difficult time for the country.

The budget seems tailored to secure PRI support. For example, the new sales tax finesses its election commitment to block the extension of VAT to food and medicines. The party has its own reasons for wanting stronger public finances, since they would yield more resources for state governors, of whom the PRI has a majority. But it is certain to tinker.

Lacking its old subordination to executive power, the PRI is more than ever an agglomeration of factions and barons. Its attitude to substantive reforms, such as another energy law or modernising the political system, will depend in part on the battle inside the party for its presidential candidacy. For the next year or so Mr Calderón can expect grudging support, at best.

"The PRI does not have a joint responsibility with the national government," insists Enrique Peña Nieto, the governor of Mexico state, who is one of the party's presidential hopefuls. "All we have is a majority in one house and our governorships. The executive has its agenda, and we have ours." Those Mexicans who agree that their country must change will hope the two coincide.

Venezuela and Colombia

Politics versus trade

Sep 10th 2009 | SAN ANTONIO DEL TÁCHIRA
From The Economist print edition

Hugo Chávez stamps out regional economic integration



BUSINESS is slack at José Nelson Uribe's tiny grocery store in San Antonio del Táchira, just a stone's throw from Venezuela's border with Colombia. "I'm not selling even a quarter of what I sold before," says Mr Uribe. His woes are a result of the political conflict between his namesake, Colombia's president, Álvaro Uribe, and Venezuela's Hugo Chávez. "Before" means before July 28th, when Mr Chávez declared a "freeze" on diplomatic ties and said he would seek alternatives to Colombian goods. This was officially a response to an agreement formalising American use of seven Colombian bases for anti-drug operations, but it also coincided with questions as to how anti-tank rocket-launchers sold by Sweden to the Venezuelan army ended up in a camp belonging to the FARC guerrillas in Colombia. It is not the first time that Mr Chávez has threatened trade sanctions, but this time he seems serious.

The impact on the border region was swift. For each country, the other is the second-biggest trading partner (after the United States in both cases). Bilateral trade totalled $7.2 billion last year, of which $6 billion consisted of Colombian exports, mainly of food, live animals, clothing and cars. Four-fifths of that trade passed along the twisting mountain road that links San Antonio with the state capital, San Cristóbal. "That represents 50,000 direct jobs and 250,000 indirect [ones]," says José Rozo, a local business leader. Many of these are in transport firms and customs agencies. "Before, the local lorry drivers were doing around 500 trips a day," Mr Rozo says. "Now it's down to about 80." Industry in Táchira has been hit too, since many companies depended on imports from Colombia.

The border is not closed. But few of the 30,000 Colombians who used to cross each day to shop do so now, because Venezuela's National Guard confiscates their goods when they recross the border, says Mr Uribe, the shopkeeper. Venezuela's government has stopped issuing import permits, nor is it providing dollars at the official exchange rate for imports from Colombia (a dollar costs almost three times more on the parallel market).

Many of the businesses in Táchira are owned and staffed by Colombian migrants, and the state is governed by the opposition. But the trade sanctions will hurt Venezuelans throughout the country, albeit less visibly. To substitute Colombian goods, Mr Chávez signed import deals with Argentina worth $1.1 billion, including 10,000 cars (an import quota previously assigned to Colombia), medicines, 2m pairs of shoes and rice. The government claims these will work out cheaper, partly because import tariffs will be waived. But it is not clear whether Argentina's farmers, who have suffered drought and punitive taxes, can deliver the goods. And Venezuela's inefficient ports are already choked.

Trade has hitherto served to damp down the frequent flare-ups between Mr Chávez and Álvaro Uribe, political opposites who share a volatile temperament. Luis Carlos Villegas, the head of Colombia's industrialists' association, says that although exports will fall, they will remain "high" because of the two countries' economic interdependence. But some Colombian businesses are already looking to other markets in Latin America and beyond. "We will not accept threats and blackmail," says Javier Díaz, president of the National Association of Exporters. "We will keep selling to them, but we can no longer depend on the Venezuelan market." Exports were already falling before the latest measures. Colombian exporters say they are owed $545m by Venezuelan importers, whose payments must be approved by the government's foreign-exchange authority. Brazilian exporters make similar complaints. Although some Colombian businesses will adapt, clothing makers, cattlemen and car-assembly firms may find it hard to find other markets.

The main winners in all this are the mafias who smuggle petrol, foodstuffs and other goods across the border. "These gangs involve powerful interests, linked to both civilian and military authorities," says Mr Rozo. "Their capital comes from illicit activities like drug-trafficking and kidnapping." Local people say lorries apparently loaded with smuggled goods are crossing the border nightly.

Ecuador, Argentina and the IMF

The price of pride

Sep 10th 2009 | BUENOS AIRES AND QUITO
From The Economist print edition

Life outside the system becomes a bit harder

WHEN the world economy was booming and prices for South America's commodities were high, several left-wing governments in the region liberated themselves from what they denounced as the oppressive tutelage of the IMF, and embarked on a dash for growth powered by big increases in public spending. In today's straitened times, such policies are harder to finance.

First to find this out is Ecuador. High oil prices allowed Rafael Correa, its socialist president, to ramp up spending on social programmes and to win a second term at an election in April. But oil output and remittances from Ecuadoreans abroad are both falling. Despite better tax collection, the budget deficit is heading for around $1.5 billion this year. Since Ecuador adopted the dollar as its currency after a financial meltdown in 1999, the government must borrow this money and cannot print it.

It risks running out of willing lenders. In December and March it defaulted on bonds totalling $3.2 billion, which it argued were "illegitimate and illegal". It then bought most of them back for only about a third of face value. It thus has no immediate prospect of issuing new bonds in international markets. The government has pocketed its $400m share from the recapitalisation of the IMF, but refuses to contemplate swallowing its pride and seeking loans from the fund or the World Bank (with which Mr Correa also quarrelled).

Instead it is tapping regional lenders and others farther afield. Ecuador has borrowed as much as it can from the Andean Development Corporation, but it hopes for another $500m from the Inter-American Development Bank. The Latin American Reserve Fund has provided $480m. China has offered $1 billion at 7.25% (three times the rate demanded by the IMF) in return for future oil shipments. This is a "commercial operation" by Petroecuador, the state oil company, rather than a government loan, says María Elsa Viteri, the finance minister. Officials hope for €100m ($145m) from Iran's Export Development Bank (whose assets in the United States were frozen last year because of its alleged funding of nuclear programmes).

With reserves falling (see chart), Mr Correa tried to stop capital flight. He has forced banks to hold at least 45% of their deposits at home. He wants to double the capital-export tax to 2%, and to increase corporate taxes. He has already tapped the social-security fund. But the government may merely be buying time at the risk of exacerbating its problems. Already the president has had to apologise to the police and army for delays in paying their salaries, and public investment has been cut. Jaime Carrera of the Fiscal Policy Observatory, an NGO in Quito, reckons that the government will find it even harder to finance next year's deficit, which he forecasts at 2.5% of GDP. The government is betting on a higher oil price and on new hydroelectric plants, which will cut spending on subsidies for imported energy. But neither may have much effect before 2011.



Like Ecuador, Argentina quarrelled with the IMF and defaulted on its bonds. But the government of President Cristina Fernández has more options than Mr Correa's—and it is showing a little bit more flexibility. The economy minister, Amado Boudou, said at a meeting of finance ministers from the G20 countries on September 5th that Argentina would, in principle, open its books to the IMF. If that happens, it will be the fund's first assessment of the country's economy since 2006, when Néstor Kirchner, Ms Fernández's husband and predecessor, broke with it.

Mr Boudou is not asking for a loan from the fund. The Kirchners are unlikely to nibble humble pie unless

Argentina is starving, which it is not—nor is it likely to for the foreseeable future. But the public finances are under pressure. The primary fiscal surplus (ie, before debt payments) has shrunk, probably to little more than 1% of GDP. (That looks good compared with many countries—but Argentina lacks their scope to borrow in international markets.) Ms Fernández is unpopular, making it harder for her to raise taxes or cut subsidies.

But there are signs of recovery. Miguel Kiguel, an economic consultant in Buenos Aires, estimates that the economy is now growing at an annualised rate of about 2%. Confidence is starting to return. The Central Bank has intervened less to prop up the peso and capital flight is easing. That means Mr Boudou's flirtation with the fund is unlikely to go very far.

To qualify for the fund's new flexible credit line, Argentina would have to clean up its statistics office, which is run by nominees of Mr Kirchner, not the economy minister. It would also have to reach a deal with the holders of some $20 billion of bonds who held out against a tough debt restructuring in 2005. Barring a renewed deterioration in Argentina's fortunes, it is likely to be left to Ms Fernández's successor to restore the country's financial ties to the outside world.

Canada's wine industry

Outsourcing terroir

Sep 10th 2009 | OTTAWA
From The Economist print edition

Blended deceit from the nanny state

Alamy



Bottled here, not just cellared

THE idea of Canadian wine invites disbelief in those who think of the country as being a frozen wilderness. In fact, British Columbia's Okanagan Valley, blessed with a Mediterranean microclimate, is home to some respectable vintages and southern Ontario, on the same latitude as France's Languedoc, produces passable plonk. Partly thanks to government subsidies, the wineries have raised the quantity and quality of their output, won a few international awards and notched up modest export sales.

Some wine producers fear that their new status risks being undermined by loose labelling allowed by Ontario, Canada's most populous province. It lets wines made with up to 70% imported grapes be sold as Canadian. The small print declares, ambiguously, that these impostors were "cellared in Canada", but they are otherwise indistinguishable from the real thing. British Columbia follows a similar practice.

This laxity dates from when Canadian wine makers struggled to get enough local grapes. It is backed by Canada's two biggest wine companies, Vincor Canada (a subsidiary of Constellation Brands, an American wine giant) and Andrew Peller. They argue that they cannot compete with cheaper imports from Chile and Australia unless they use bulk wines from those same countries.

Smaller wineries in both British Columbia and Ontario, which produce better-quality wines, say the labelling is devaluing their image. They want the rule changed. They accuse the Liquor Control Board, an arm of Ontario's government that holds a monopoly on off-sales in the province, of siding with the heavyweights. The board displays their blended wines on the shelves dedicated to promoting local products at the front of every store. It is bad enough for consumers to have to buy wine from the government. Why the government thinks consumers should be hoodwinked in the cause of trying to compete with Chile and Australia in wine production is even more baffling.

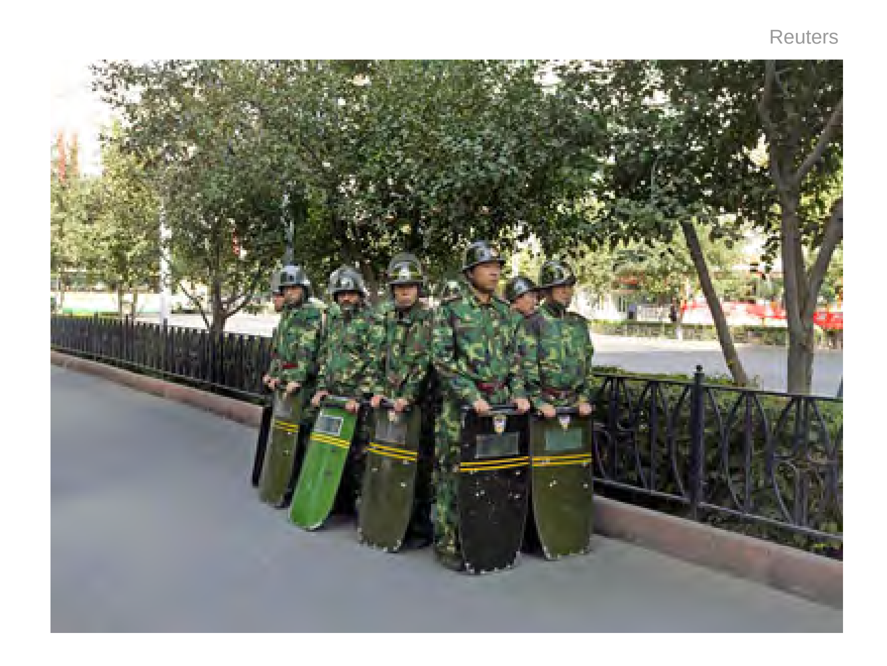
Tension in Xinjiang

The party under siege in Urumqi

Sep 10th 2009 | URUMQI
From The Economist print edition

Two months after a bloodbath, inter-ethnic relations remain on a short fuse

Reuters



HECKLING a member of the ruling Politburo; chanting for him to step down: rarely in the history of Communist rule in China have such scenes been witnessed. But Wang Lequan, the Communist Party chief of China's western region of Xinjiang, reportedly suffered just such an indignity in the region's capital, Urumqi, on September 3rd. Inter-racial tensions in the city have begun to turn into hostility towards the region's leadership, prompting a new security clampdown.

Between September 2nd and 4th, thousands of ethnic-Han Chinese took to the streets of Urumqi to protest against what they saw as the government's failure to halt an alleged new upsurge of violence by members of Xinjiang's main indigenous ethnic group, the Uighurs. Both the government and Han residents accuse Uighurs of carrying out widespread stabbings since mid-August, using syringes, safety pins, needles and other sharp objects. The attacks follow an outbreak of inter-communal rioting in early July that left nearly 200 people dead, the majority of them, by the government's account, Han.

The demonstrations, particularly at their peak on September 3rd, were large and unusually blunt in a country where few normally dare to speak ill in public of senior party leaders. At one point Mr Wang emerged onto People's Square in the centre of town to address the demonstrators, promising harsh treatment for the perpetrators of the stabbings. Residents say plastic water-bottles were thrown in his direction. Mr Wang clearly felt he had to respond. On September 5th he announced the dismissal of the party chief of the city and Xinjiang's top police official. Many believe Mr Wang is a close ally of Hu Jintao, China's president and Communist Party leader. He himself keeps his job, for now.

Ostensibly to curb the stabbings, but probably just as much to prevent further Han protests, security in the city has been tightened. Riot police stand guard at many intersections, some of them carrying bayoneted rifles. Posters have been pasted on walls calling for the "resolute stopping of illegal gatherings, marches and demonstrations". Residents say the police mean business. Tear-gas and batons were used to break up the recent protests. The authorities say five people were killed, although they have not explained how.

The fresh turmoil would have been embarrassing enough for Xinjiang's leaders even without the shouts of "down with Wang Lequan" that were heard during the protest on September 3rd. President Hu had visited Xinjiang just a few days earlier. During his tour he spoke of "victory" in Urumqi's efforts to restore

stability. The sudden pre-dawn arrival in the city of Meng Jianzhu, China's public-security minister, on September 4th suggested that leaders in Beijing had changed their minds. The stabbings, said Mr Meng, were part of the same campaign by Uighur separatists that lay behind the riots in July.

Urumqi's leaders had reached the same conclusion. On September 2nd posters appeared around the city saying that 418 people had reported being stabbed or pricked. It said this was "no ordinary political incident" but rather a "serious terrorist crime". By the time *The Economist* went to press, the number of reported cases had risen to more than 600; 45 alleged perpetrators had been detained and eight charged.

The government, however, has produced no evidence of any terrorist link. Despite the fear of many of Urumqi's Hans that the attackers might be trying to spread HIV, there has been no word that officials have detected any poison or harmful viruses. China's press has taken to calling these "syringe attacks", but the Urumqi authorities use the more general term "needle-like objects". They say that fewer than one-fifth of reported stabbings have left any obvious mark. The government news agency, Xinhua, quoted experts who said that some prickings were mosquito bites or merely imagined.

By sacking two of his underlings, Mr Wang has done little to deflect public anger. Many Han Chinese complain that the government has not done enough to keep them informed. The internet in Xinjiang has been cut off since the riots in July. The authorities warned citizens of stabbings in late August by text message (a means of communication also blocked for non-official purposes), but did not provide fuller details until September. Many Han Chinese say they no longer dare go into Uighur areas or eat in Uighur restaurants. If this is what China's president sees as victory, defeat would be grim indeed.

Vietnam's nationalist bloggers

Getting it off your chest

Sep 10th 2009 | HANOI
From The Economist print edition

A crackdown on online patriotism

Illustration by Claudio Munoz



IN A country as fiercely patriotic as Vietnam, you would expect the government to cheer a plan by citizens to distribute T-shirts bearing nationalistic slogans. However, the T-shirts in question carried messages of hostility towards China, Vietnam's biggest trading partner. Worse, their pedlars were popular and sometimes critical bloggers.

Two well-known bloggers and an online reporter have been detained after the police uncovered an apparent attempt to print T-shirts opposing Chinese investment in a controversial new bauxite-mining project in Vietnam's Central Highlands and casting doubt on China's claims to disputed islands in the South China Sea.

The trio, who had all written critically about Vietnam-China relations on the internet, were detained on suspicion of "abusing democratic freedoms" to undermine the state. By the middle of this week Bui Thanh Hieu, a blogger who used the pen name Nguoi Buon Gio ("Wind Trader"), and Pham Doan Trang, a journalist who works for VietnamNet, a news site, had been freed without charge after several days in detention. Nguyen Ngoc Nhu Quynh, who blogged as Me Nam ("Mother Mushroom"), was still in custody.

These are the latest arrests in a continuing crackdown against bloggers and journalists. Ahead of a congress of the ruling Communist Party in 2011, when the country's top three political posts will be up for grabs, the government is keen to rein in more outspoken commentators. Last December it imposed new restrictions on bloggers, making it illegal for them to publish under a pseudonym or to write about politics. Policing these rules will be hard.

More than 21m people, a quarter of the population, use the internet, according to government figures. Estimates of the number producing blogs range from a low of 1m to as many as 4m. The vast majority are personal diarists, not sociopolitical activists, but the spectacular growth of blogs and the difficulty of regulating them make the government, used to exercising total control of the media, twitchy.

Bloggers who have found themselves in the dock include some who have exposed government corruption or made negative remarks about the former Soviet Union. But the government seems particularly anxious about criticism of China.

Many Vietnamese remain hostile to their northern neighbour, after 1,000 years of imperial domination and a bloody border war in 1979. But the country runs a large trade deficit with China and needs its investment more than ever. This explains the government's eagerness to push ahead with the Chinese bauxite-mining project, despite widespread criticism from scientists and generals (as well as bloggers). They have questioned Chinese companies' environmental records and expressed their fears for national security.

International press-freedom groups, which often rank Vietnam alongside China and Myanmar as among the riskiest countries for bloggers, have condemned the latest arrests. Foreign diplomats fear that the clampdown will harm the fight against corruption. The new rules may cow bloggers, and journalists may be too scared to cover anything even vaguely risky—the law is unclear about what they can and cannot report.

But not everyone is deterred. "They only ever go after the big fish," says one young Hanoi blogger, who has also openly criticised China many times. Besides, he adds, the government may be shooting itself in

the foot. When bloggers are arrested, their readership usually takes off.

Kazakhstan's human-rights record

Dangerous driving

Sep 10th 2009 | ALMATY
From The Economist print edition

A car accident gives a reason to put an irritant behind bars

NEARLY two years ago, Kazakhstan was awarded the 2010 chairmanship of the Organisation for Security and Co-operation in Europe (OSCE). There was much debate about the country's credentials. The OSCE, which monitors human rights and elections in its 56 members, has never judged an election in Kazakhstan free and fair. Yet some observers hoped that the pride of the one-year chairmanship would inspire human-rights improvements.

Yevgenii Zhovtis, Kazakhstan's best-known human-rights activist, was one such hopeful observer. He believed at the time there was little else left that could push a country with a one-party parliament and growing oil exports towards change. But in spite of some legislative reform, the overall human-rights situation has since become noticeably worse, particularly over the past six months.

Starting this spring, an unprecedented wave of arrests of government and state-company officials and bankers on various charges—mostly corruption or embezzlement—has caused alarm. A number of people, fearing they may be next, have left the country. Some arrests seem unconnected with actual wrongdoing and have been widely attributed, including by Mr Zhovtis, to behind-the-scenes struggles among the elite.

This month Mr Zhovtis himself, one of the government's few outspoken critics, became a victim. A deplorable incident gave the state a chance to silence him by throwing him in jail. In late July Mr Zhovtis was driving a car that killed a man walking on a country road late at night. Mr Zhovtis claimed he did not see the pedestrian and was blinded by the lights of an oncoming car. On September 3rd, after a two-day trial, a court in the Almaty region disagreed and found Mr Zhovtis guilty of vehicular manslaughter and sentenced him to four years in jail.

Although there is no doubt that Mr Zhovtis was behind the wheel and that a person was left dead, the verdict and the way the trial was conducted have provoked outrage. The defence was granted only about 40 minutes to prepare its closing argument. The judge then took only 15 minutes to deliver his verdict, which was several pages long, leading to questions about when it was written. The American embassy, international human-rights groups and the OSCE itself have called on Kazakhstan to give Mr Zhovtis access to fair legal proceedings.

His colleagues have denounced the trial as politically motivated and have formed a committee in his defence. They see it as a punishment for his 20 years of human-rights work. But there is one small ray of hope for those despairing of human-rights improvements. Mr Zhovtis, a lawyer himself, has already started giving legal advice to his cellmates.

War in Afghanistan

Collateral damage of every sort

Sep 10th 2009 | BERLIN AND KUNDUZ
From The Economist print edition

The West's mission in Afghanistan is under attack on many fronts

AFP



At least they hit the target

WITH tension high after a difficult and partly rigged election, the last thing NATO forces in Afghanistan needed was for scores of Afghan civilians to be killed by yet another fumbled attack. But on September 4th a German commander called in an American air raid near Kunduz, in the north, against Taliban insurgents who had stolen a pair of fuel trucks. Scores were killed, not all of them Taliban. The repercussions were felt across Afghanistan, and in Germany itself.

Four of the five main parties contesting the parliamentary election in Germany on September 27th support the deployment of troops in Afghanistan. But most voters do not. So a conspiracy of silence has kept one of the touchiest issues out of the political debate. The silence has now been shattered. Citing a NATO fact-finding mission, the *Washington Post* reported that about 125 people were killed, many of them civilians, on the basis of intelligence provided by a single Afghan informant.

General Stanley McChrystal, the new American commander of ISAF, the NATO-led force, has stressed the importance of reducing civilian casualties, and was said to be "incandescent". The German government's first reaction was confused. The defence minister, Franz Josef Jung, insisted that only Taliban died, but later admitted that this might not be so. The defence ministry says 56 people died.

Often mocked for confining its 4,200 troops to the relatively safe north, Germany now stands accused of overreacting when a threat appears. It has responded angrily. The defence ministry stands by the decision to destroy potential "rolling bombs" that could have been used against German troops. The air raid took place less than four miles (6.4km) from the German forces' base.

German politicians have tried to portray the Afghan deployment not as a combat mission but as a humanitarian one. That claim now rings hollow. Germany's participation in ISAF must be debated anew by the parliament, the Bundestag, in December. There is little doubt that it will be renewed, but pressure is growing for an exit strategy. The chancellor, Angela Merkel, has joined Britain's prime minister, Gordon Brown, and France's president, Nicolas Sarkozy, in calling for an international conference on how to shift responsibility for security from ISAF to the Afghan government. But America is expected to ask for more from its allies, not less.

One reason for this is the deterioration in security both in the insurgency-ridden south and in Kunduz and some other parts of the north. It was in the plains around Kunduz that the Taliban surrendered to the Northern Alliance in late 2001. Restricted from joining combat operations, German forces there have tried to concentrate on development projects. But last year saw a fivefold

increase in “security incidents” in the ethnically diverse province. This year has been even worse. In Chahar Dara district, an ethnic-Pushtun stronghold, aid workers are leaving and Afghan contractors are often forced to pay protection money to prevent the kind of roadside ambushes and improvised explosive devices that are aimed at German troops.



It was there that a British journalist, Stephen Farrell, was held this week after being kidnapped while investigating the air strike. He was later rescued by NATO soldiers in a pre-dawn raid. But, further souring attitudes to foreign forces, his Afghan colleague, Sultan Munadi, and two other Afghan civilians died in the operation. A British soldier was also killed.

In Chahar Dara militants travel around in their dozens in open lorries. They extort food and taxes from local people, often taking more than 10% of their income. They have also begun to man checkpoints on the highway that runs south from Uzbekistan and Tajikistan, a vital alternative to the Khyber Pass as an ISAF supply line.

For all its modern firepower, armoured vehicles and thousands of troops, the German army has made little headway against the militants. In July a 2,000-strong clearing operation tried to pacify Chahar Dara before the presidential election on August 20th. Locals say the militants, including some from Uzbekistan and the Afghan south, left the area only to return later, and more are coming every month. Mullah Omar, the Taliban leader, has reportedly called on his fighters to open a new front in the north to stretch coalition forces.

Violence across the region surged in the run-up to the election. On polling day itself rockets were fired into Kunduz city for the first time since 2001. Neighbouring Baghlan saw the worst bloodshed of any province.

President Hamid Karzai seems certain of winning his second term, despite charges of massive vote-rigging. By mid-week, results showed him with 54% of the votes, after nearly all had been counted. But a United Nations-backed watchdog ordered a partial recount, and final results are not expected until the end of the month. With so much evidence of fraud, supporters of Mr Karzai’s main challenger, Abdullah Abdullah, may not accept the victory. Unrest is still possible. And in the north, a region where security has long been taken for granted, Taliban advances are rattling foreign forces’ resolve.

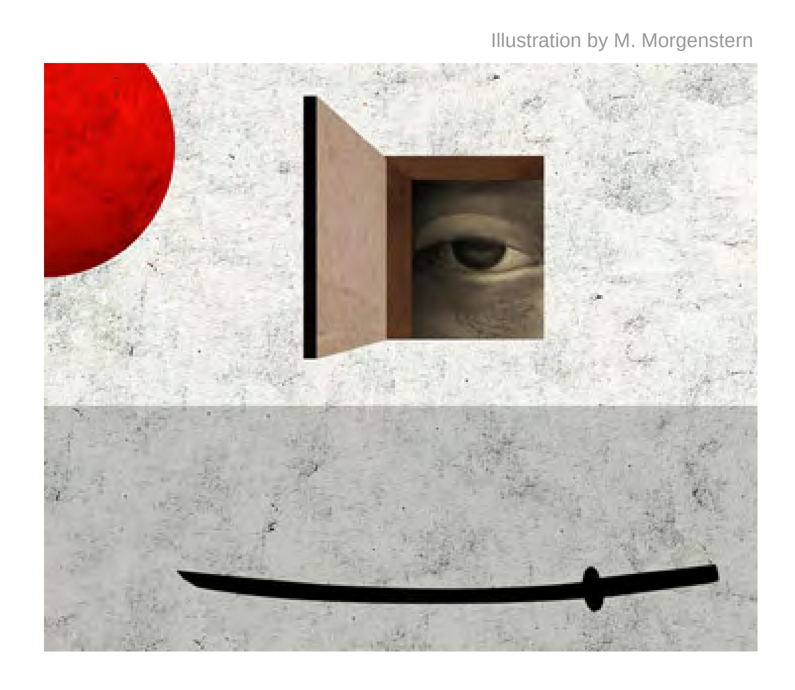
Banyan

Ichiro Ozawa: the shadow shogun

Sep 10th 2009
From The Economist print edition

It is not just the opposition that Japan's new prime minister has to worry about

Illustration by M. Morgenstern



BEFORE the momentous victory of the Democratic Party of Japan (DPJ) on August 30th, the prize for the living politician with the profoundest impact on Japan's politics might still have gone to Junichiro Koizumi, dazzling prime minister from 2001 to 2006. After it, many abroad might award the prize to Yukio Hatoyama, who will become prime minister on September 16th. In fact, the case for Ichiro Ozawa, the organisational force behind the DPJ's landslide, is nearly bombproof.

Abroad and at home, Mr Koizumi is more familiar than both. His sleight-of-hand was to appear to be running against his own Liberal Democratic Party (LDP) when he was running for it. Yet Mr Koizumi paid mostly only lip-service to the idea of smashing the post-war system in which LDP factions had monopolised—and more recently paralysed—political decisions. With hindsight, he merely postponed the devastation that Mr Ozawa has just unleashed by selecting and grooming fresh candidates to unseat the LDP dinosaurs. Now LDP extinction looms.

For nearly 20 years Mr Ozawa, with black bags under half-closed eyes that give him the look of a dissolute eagle, has sought that devastation. In 1993 "the Destroyer" triggered the LDP's first-ever fall from power, by storming out with his followers. Eleven months later, the LDP was back. This time the damage will be longer-lasting. With the end of the cold war, Mr Ozawa recognised that the "LDP system", founded in 1955, had outlived its purpose. Political competition, he never stopped arguing, should be organised around the policy choices of two main parties, not around personality and pork. In this goal Mr Ozawa is the constant man of Japanese politics. Yet there are other constants to the 67-year-old's four-decade-long political career. They include a Machiavellian penchant for the shadows; a fondness for flashes of personal power; a cruel delight in seeing others submit; extreme and sudden risk-taking; and no compunction to explain or confer.

In the LDP Mr Ozawa was bag-carrier to Kakuei Tanaka, the most powerful—and corrupt—post-war politician. Even after he resigned as prime minister, Tanaka was head of the LDP's largest faction and was the country's *yami* shogun (shadow shogun). From him, Mr Ozawa learnt how to wield power from out of sight. Mr Ozawa was kingmaker, as both faction leader and LDP secretary-general, but never prime minister. Rivals hated him.

But if the Destroyer brought the LDP government down in 1993, he also unwittingly brought down its

replacement, in whose creation he had played the central hand. Indeed, his machinations drove the Socialists, the establishment's sworn enemy, into the LDP's arms—no mean feat. And in 2007 he shocked his colleagues again, by discussing a coalition with the LDP. DPJ executives, led by Mr Hatoyama, were appalled. His colleagues, he later said, failed to see he meant to bring the LDP down from within.

All this has a bearing on the DPJ today. Mr Ozawa had been party leader until May, when allegations of fund-raising irregularities in his own office forced his resignation. Now his successor, Mr Hatoyama, has made Mr Ozawa the DPJ's secretary-general, a powerful party post but outside the government. His brief, says Mr Hatoyama, is to oversee the 2010 election for the upper house of the Diet (parliament). Others want Mr Ozawa to act as mentor to the DPJ's huge cohort of wide-eyed freshmen.

If Mr Ozawa focuses on these jobs, then Mr Hatoyama can get on with his. More than anything, Japan voted on August 30th for clearer, more accountable government. Under the LDP, party politicians often subverted the government's agenda. Bureaucrats wielded disproportionate power. Mr Hatoyama promises to vest authority in the cabinet—Westminster is cited as the model.

But Mr Hatoyama, scathingly described by a former prime minister, Yasuhiro Nakasone, as "soft-serve ice-cream", has yet to show his mettle. Though the grandson of the LDP's first prime minister, he comes across as too decent for politics—one reason he needs Mr Ozawa as a guardian. Mr Ozawa now controls the party's purse strings. The DPJ's landslide gives him huge prestige. Many new MPs owe their seat to him. In effect, says Takao Toshikawa, editor of *Tokyo Insideline*, a newsletter, Mr Ozawa controls 140-odd "Ozawa kids"—about as large a faction as Tanaka ever boasted. Should the Destroyer revert to type he could undermine the government with devastating informal power.

The real revolution: a different Japan

Perhaps, though, Mr Ozawa's power is all about perception. The glare of sunlight on the political process, as Mr Hatoyama will attempt with cabinet-led government, might wither Mr Ozawa's dark powers. And not all of the DPJ's new recruits will feel beholden to him: the DPJ shuns formal factions.

But it is still helpful to think of Mr Ozawa as a revolutionary, putting ends above ruthless means. Destroying the LDP may merely have been a means towards his abiding end: to see Japan become a more "normal" country, ie, more in control of its destiny. For nearly 20 years Mr Ozawa has argued that Japan's foreign policy has been shaped by the subservience to the United States that followed defeat, and by a wish to do everything, especially defence, on the cheap. In future, he says, Japan should pursue its own path when its interests diverge from America's, refusing help to America's global military adventures, and joining only those missions led by the United Nations. Mostly, he says, it should concentrate on its standing in its Asian backyard.

These views, shared by Mr Hatoyama, are not anti-American. But they challenge plenty of assumptions. One is that Mr Ozawa will now mellow and fade. Another is that the new government will allow domestic concerns, however pressing, to crowd out a foreign agenda. Americans expecting their security alliance to cruise along as normal should take note.

Economist.com/blogs/banyan

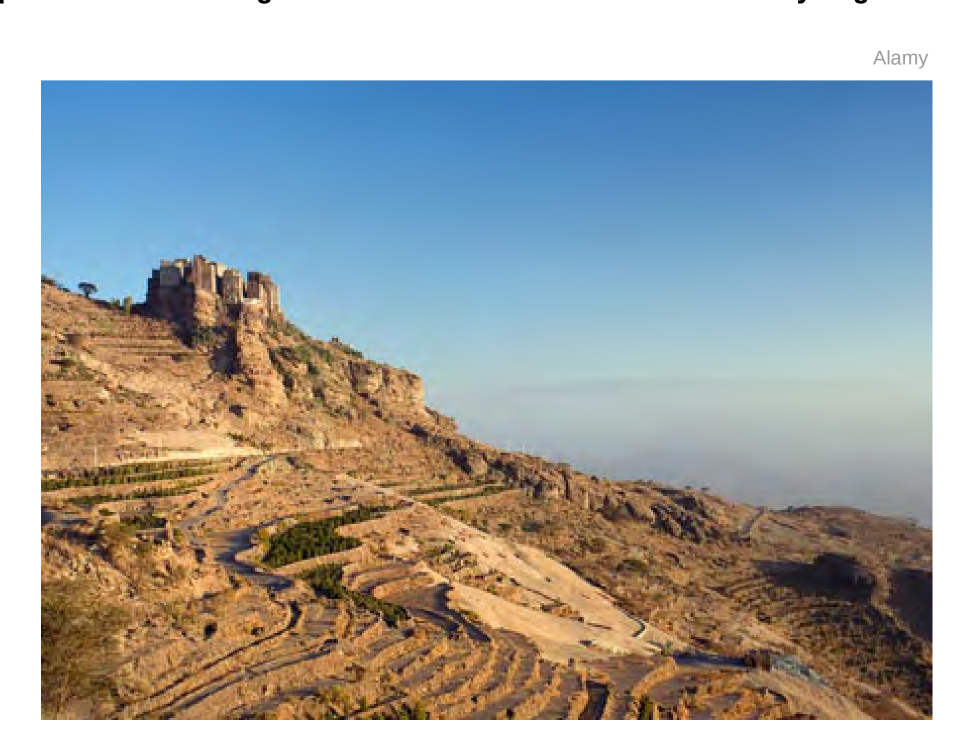
Strife in Yemen

The world's next failed state?

Sep 10th 2009 | CAIRO
From The Economist print edition

A beleaguered president is taking brutal measures to hold his country together

Alamy



SOLDIERS mostly aim better with bullets than with words, but Yemen's army can claim unwonted accuracy in its latest offensive, Operation Scorched Earth. Judging from reports of MiG fighter aircraft, helicopter gunships, tanks and Katyusha rockets churning up the spectacular mountainscapes of the country's rugged north-west, the description is fitting.

The UN says at least 50,000 people have fled since fighting began in August. Thousands more may be trapped in remoter parts of the war zone, which spreads across an area the size of Wales that borders Saudi Arabia and protrudes south to within 50km (30 miles) of Sana'a, Yemen's capital. With reporters banned and aid workers severely restricted, the overall casualty count is unknown. What is certain is that the latest batch of refugees must be added to the 150,000 civilians already uprooted during five previous rounds of the conflict, which started in 2004.

The clashes pit regular government troops, backed by lighter-armed tribal allies, against tribesmen loyal to the Houthi family, a powerful northern clan. The Houthis style themselves mujahideen, in the manner of the guerrillas who chased the Russians out of Afghanistan. Their slogan—"Death to America! Death to Israel! Curse upon the Jews! Victory to Islam!"—would suggest a link to global jihadists. But most of their adherents belong to the Zaydi sect, a normally quietist branch of Shia Islam that is unique to Yemen and which most Sunnis regard as quaintly schismatic.

Zaydis make up a third of Yemen's 30m people, and for centuries formed the ruling elite in its mountain heartlands. They remain well represented in government; President Ali Abdullah Saleh is one. But some provincial Zaydis resent the republic that overthrew Yemen's last Zaydi monarch in 1962, and which Mr Saleh, a former tank commander and relative commoner, has run since seizing power in 1978.

Friction has mounted owing to pervasive corruption that favours Mr Saleh's own clan, to his craftiness at playing Yemen's numerous gun-toting tribes against one another, and to his perceived cravenness towards Saudi Arabia. Many Yemenis, pointing to a surge in religiosity among their own Sunni majority, see their rich, radically conservative Sunni neighbour as a pernicious cultural influence.

Yet, as in a family feud, Yemenis struggle to explain what started the Houthis' quarrel with the government. Its roots go back to the early 1990s, when Saudi Arabia expelled nearly a million Yemeni workers to punish Mr Saleh for backing Saddam Hussein's Iraq in the first Gulf war in 1991. This influx drew recruits into a radical Zaydi cult, known as the Believing Youth, that had been launched by a charismatic member of the Houthi family. Building on perceived government neglect of the north, a deprived region where the lucrative smuggling trade was badly hit by the squabble with Saudi Arabia, and acting on the Zaydi doctrine of legitimate resistance to inept rule, the group soon found itself in opposition to the government in Sana'a.

In a country awash with guns where central authority has always been weak, such tensions tend to be expressed violently. In the first round of open warfare in 2004, government forces killed or captured much of the Houthi leadership. Yet, despite their small number, the Houthis have not only survived repeated batterings, but thrived.

Much of the reason for their success lies with the army itself. Its aerial bombing and artillery fire have proved better at enraging locals than at subduing bands of guerrillas; and its induction of tribal allies has pushed their traditional rivals into the Houthis' arms. The army's need to man fixed positions in remote areas and to mount convoys on main roads has provided plum targets. Most of the Houthis' heavy equipment is captured booty, though they have bought more from corrupt officers or in the market in Saada, the region's capital. With such things as rocket-propelled grenades and anti-aircraft guns on open display, Saada is said to boast the best-stocked arms bazaar west of Pakistan's Peshawar.

After the last round of clashes sputtered out in July 2008, Houthi forces quietly regained possession of much of the country around Saada, positioning themselves to block the few roads that give access to the rest of the country. Despite the ferocity of the present onslaught, they do not appear to have been dislodged. The government claims advances but Houthi videos posted on YouTube show captured army tanks and soldiers. Each side accuses the other of atrocities and of acting as a cat's-paw for foreign powers. The government says the Houthis are fighting for Iran. The rebels say the government truckles to the Saudis.

Such reasoning comforts Yemenis, many of whom prefer to blame their troubles on regional power games. But although there is no proof of Iranian involvement, Saudi Arabia does have a legitimate interest in helping Yemen's government control its side of their mutual border. The kingdom is, in fact, a reluctant ally of Mr Saleh, as are the Western donors whose aid has long propped up his regime. But with even more perilous potential threats to Yemen looming, such as growing unrest in the once-separate south and menacing signs of a resurgence by affiliates of al-Qaeda, Mr Saleh can still plausibly pose as the only man stopping the country from becoming the world's next failed state.

The Palestinians' West Bank

Not as horrible as it was

Sep 10th 2009 | JALAZUN
From The Economist print edition

Even though a formal peace process between Israeli and Palestinian negotiators has yet to resume, life on the West Bank—but not in Gaza—is slowly improving

A COUPLE of brown sheep squeal and squirm as they are dragged into the backyard of the Alian family's house in the Jalazun refugee camp, north of the West Bank city of Ramallah. A man slits their throats, spraying the wall with blood. Once the sheep are motionless, women silently start cutting the meat into neat portions to be distributed to the camp's poorest families in honour of the family's "martyr", 15-year-old Muhammad, who was recently killed by Israeli soldiers.

The Israeli army says he was throwing a Molotov cocktail at Jews in a settlement called Beit El, on a hilltop just outside the camp. A Palestinian human-rights group says the boy bled for an hour before Israeli soldiers let him have medical attention. The army denies the charge.

In past years a boy's death during the Muslims' holy fasting month of Ramadan, which began last month, would have unleashed riots in the Palestinian territories, but this time the reaction was muted. Palestinian policemen with semi-automatic rifles and baseball bats were posted on street corners throughout the camp after the killing, not to squash anti-Israeli demonstrations but to quell a lethal feud between two local families.

These tough-looking young policemen, trained in Jericho and Jordan under the aegis of an American security co-ordinator for the Palestinian territories, General Keith Dayton, have brought a modicum of calm and safety to Palestinian streets—to the benefit of Israelis too. Only a handful of suicide attacks have been carried out in Israel since 2005.

By clamping down on crime and guerrilla violence in the West Bank, the Palestinian security forces have enabled Israel's forces to pull back from most of the Palestinian cities. Israelis say their own security barrier, biting into the West Bank, has helped keep miscreants out. Moreover, Hamas, the Islamist movement that carried out most of the suicide attacks, has, with the odd exception, desisted for several years. Israelis are less afraid to frequent restaurants and markets.

Violence still erupts occasionally. Israeli forces have killed 16 Palestinians in the West Bank so far this year, against 42 last year, says B'Tselem, an Israeli human-rights group. But many of the checkpoints choking movement and trade in the Palestinian territory have been removed. For the first time in several years, a sense of cautious hope is spreading.

In June the World Bank issued a perkier-than-usual report on the Palestinian economy, predicting that it would grow this year by 5%. In the Ramallah area, buildings are going up fast; new malls and shopping centres have opened. Since May the Israeli government has let Israeli Arabs visit West Bank cities, where they can buy things more cheaply, and this can help boost the economy.

These improvements in the daily lives of West Bankers have bolstered the ruling Fatah party. A recent poll by the Palestinian Centre for Policy and Survey Research reckons it would get 44% of the vote to 28% for Hamas, its Islamist rival, which runs the Gaza Strip, if elections were held today. Partly because of a long-awaited Fatah congress last month in Bethlehem, where a younger leadership emerged, Fatah's Mahmoud Abbas, who presides over the Palestinian Authority (PA) that runs the West Bank, has become more popular.

The prime minister, Salam Fayyad, an American-educated reformer who previously worked for the World Bank and the IMF, is praised for much of the progress. He recently unveiled a plan to boost growth and set up a de facto Palestinian state in the West Bank and Gaza in two years, with or without Israel's consent. He wants, among other plans, to build an international airport in the Jordan valley, an oil refinery and rail links to neighbouring countries.

The PA's ability to build a proper state still depends on Israel's withdrawal from the land it occupied after the 1967 war and on negotiations with Israel leading to Palestinian self-rule and sovereignty. But Mr Fayyad suggests bypassing the formal peace process, now anyway at a standstill, partly because Israel refuses to stop building or expanding Jewish settlements in the West Bank and on the Arab-populated east side of Jerusalem. Last week Israel's prime minister, Binyamin Netanyahu, angered American and Palestinian negotiators by insisting that 450 housing units in West Bank settlements would be built under plans previously approved.

He also criticised Palestinians for mooting unilateral action and pooh-poohed Mr Fayyad's plan, so it has little chance of implementation any time soon. Though Palestinians can travel a bit more freely in the West Bank, the Israelis still control the borders and roads, the air space, energy and communications, access to water, and much else. Palestine's economy is still in thrall to Israel. Political uncertainty, settlement expansion, continuing closures and a host of bureaucratic hassles deter investors. Palestinian living standards are still below the level of 2000. The PA relies heavily on foreign aid.

Gaza, in any event, is a different, still far grimmer, story. Its 1.5m people, accounting for two-fifths of a would-be Palestinian state's 3.8m-plus people, still suffocate under a blockade imposed by Israel since mid-2007, when Hamas expelled the Fatah-run PA government. Nearly half of Gazans are jobless. Industry has virtually ground to a halt. Sewage is untreated. Israel refuses to let Gazans freely import building material or cement, since they may be used for military purposes. Thousands of houses destroyed during the Israeli assault on Hamas early this year are heaps of rubble. Israel wants Gazans to note the West Bank's improvement—and to back Fatah.

Things could perhaps improve if an Israeli soldier, Gilad Shalit, whom Hamas has held captive in Gaza for more than three years, is freed in a prisoner exchange that might, according to latest reports, see 450 Palestinian prisoners also released.

But even in the West Bank many Palestinians do not share the new mood of cautious optimism. An uncle of Muhammad, the boy recently killed, sits glumly outside the family's sweet shop, his eyes red with grief. He had brought the boy up as his own son, since Muhammad's father had been killed by Israeli soldiers seven years ago. Such incidents still abound, ensuring that the well of Palestinian bitterness runs deep. Most Palestinians still find it hard to conceive of a durable peace with Israel.

A metro for the Emirates

All that glisters...

Sep 10th 2009
From The Economist print edition

Dubai's visionary ruler is determined to keep smiling amid the gloom

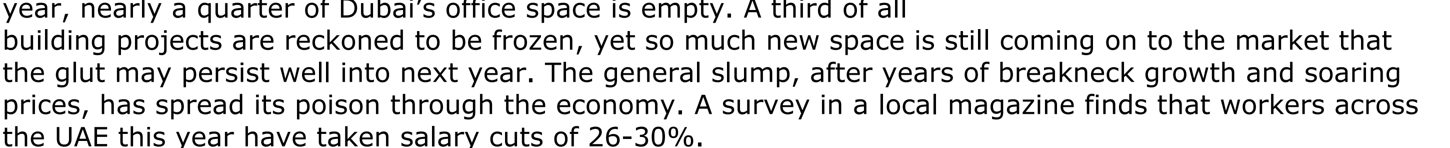
Illustration by David Simonds



THE new metro in Dubai, the glitziest but most heavily indebted of the seven statelets making up the United Arab Emirates (UAE), is not the world's biggest, fastest or costliest. But even in these straitened times, the city-state has rolled out this latest bauble with its usual flair. In flowing robes, amid laser lights and red carpets, Sheikh Mohammed al-Maktoum, Dubai's ruler, launched the inaugural service on the auspicious date of 9/9/2009.

Built by a Japanese consortium in just four years, the driverless system's first line comes complete with sleekly futuristic air-conditioned stations, leather seating for first-class passengers and carriages specially designated for women. The Arabian peninsula's first urban railway looks swell, it may unclog the roads and should be a welcome convenience to the ordinary folk who cater to Dubai's plushily motorised elite.

And yet Dubai's economy is still stalled on the tracks. Though the cost of commercial rents has fallen by half since the start of the year, nearly a quarter of Dubai's office space is empty. A third of all building projects are reckoned to be frozen, yet so much new space is still coming on to the market that the glut may persist well into next year. The general slump, after years of breakneck growth and soaring prices, has spread its poison through the economy. A survey in a local magazine finds that workers across the UAE this year have taken salary cuts of 26-30%.



Sheikh Mohammed recently likened his realm's troubles to the headwinds slowing down an aircraft. Insisting that those winds were now blowing less fiercely, he dismissed worries about government debts, which are estimated to total anything between $80 billion and $120 billion (equal to 100-150% of GDP). Dubai's intricate web of parastatal corporations controlled by the Maktoums may indeed find the cash to tide them over.

There is plenty of it still sloshing around. Where else would a government think of selling seat-belts with designer labels to promote road safety? The friendly neighbouring emirate of Abu Dhabi, which has been bailing Dubai out, is still flush with petrodollars. And Dubai still draws customers by being a pleasanter place than other Gulf destinations. Yet even Sheikh Mohammed, whose ambition has inspired Dubai's furious drive for superlatives, says he will now be more careful.

As for the metro, it is debatable whether the $7.6 billion investment will make a profit even after more of it becomes operational in five years. Dubai's rapid-transit authority says it could cut traffic by 17%, and slash losses due to delays. But how many of Dubai's 1.6m people will give up their 1m air-conditioned cars to walk even short distances in the punishing summer heat? At any rate, the sheikh can console himself with the knowledge that the metro will be the world's biggest computer-operated train system, and its Union Station will have the world's biggest underground railway concourse.

Africa's diplomacy over Zimbabwe

Robert Mugabe off the hook as usual

Sep 10th 2009 | CAPE TOWN
From The Economist print edition

African leaders fail yet again to squeeze Zimbabwe's recalcitrant president

MORGAN TSVANGIRAI, Zimbabwe's prime minister, is putting a brave face on his latest setback. But he must feel badly let down, once more, by the Southern African Development Community (SADC). At a summit meeting of its 15 leaders, the regional club failed to criticise President Robert Mugabe for his refusal to honour the power-sharing deal it helped broker a year ago. Instead, Mr Tsvangirai was fobbed off with the promise that a committee of three SADC members would eventually "review" the unity government that took office in February. Mr Mugabe is smirking.

Jacob Zuma's election as South Africa's president in May had brought hope of a tougher stance towards Zimbabwe by SADC's most powerful country after years of ineffectual "quiet diplomacy" by its former president, Thabo Mbeki. Mr Tsvangirai's expectations rose after he met Mr Zuma in Johannesburg last month. South Africa's ruling African National Congress announced that Mr Zuma would be "more vocal" than his predecessors in criticising the "adolescent" and "deviant" behaviour of Mr Mugabe's Zanu-PF party.

During a visit to Zimbabwe at the end of August, ostensibly to open an agricultural show but in truth to knock a few heads together ahead of the SADC summit, Mr Zuma pointedly stressed the importance of good governance and respect for human rights everywhere in Africa, before calling on the parties to Zimbabwe's power-sharing deal to honour their commitments and ensure its full implementation. In particular, he said Zimbabwe must, as a priority, meet the West's conditions for resuming development aid. No African leader had dared say that before.

The Americans and the European Union insist that Mr Mugabe's lot must stop abducting, arresting and killing supporters of Mr Tsvangirai's Movement for Democratic Change (MDC); cease the invasions of white-owned farms; replace the central-bank governor, Gideon Gono, and the attorney-general, Johannes Tomana; appoint new provincial governors; and free the media (see article). And they must help draft a new constitution leading to fair elections within, it is hoped, 18 months.

To stave off the humiliation of being censured by his SADC peers, Mr Mugabe has begun to make a few concessions. In the past few weeks he announced steps to end the state's monopoly over the media, and lifted a ban on correspondents from international broadcasters such as CNN and the BBC. And he has convened the National Security Council, on which Mr Tsvangirai has a seat and which is meant to replace Mr Mugabe's feared Joint Operations Command. The top military brass have even begun to salute Mr Tsvangirai, which they had sworn never to do.

Yet, with Mr Mugabe still holding the main levers of power, violence and intimidation have not abated. No fewer than 15 MDC MPs have been arrested on dubious charges since the unity government took office. More white farmers have been murdered and 170 face prosecution for refusing to leave their land. A SADC tribunal ruled last year that the seizures were illegal, but Zimbabwe's government now refuses to recognise the tribunal's legitimacy.

Meanwhile, Zanu-PF is doing its utmost to delay drafting a new constitution and to prevent fresh elections, which it knows it is virtually certain to lose. Now, with SADC apparently unwilling to squeeze Mr Mugabe, the old man and his friends can breathe more easily for a while yet.

Zimbabwe's still-muzzled press

Alternative voices longing to be heard

Sep 10th 2009 | JOHANNESBURG
From The Economist print edition

Independent newspapers are poised to come back

FOR years, newspaper readers in Harare, Zimbabwe's capital, have had their daily fare limited to the *Herald*, a state-controlled propaganda sheet that can be relied on to praise President Robert Mugabe and his Zanu-PF party, often in the most turgid prose. This week a new organ was added to their choice with the launch of *H-Metro*, a tabloid focusing on entertainment and sports. But it is part of the same Zimpapers stable. Despite promises to free the press as part of a power-sharing agreement struck by Mr Mugabe and the rival Movement for Democratic Change, the country still lacks an independent daily.

Several publishers are waiting impatiently in the wings. Among them are Associated Newspapers of Zimbabwe, which used to publish the *Daily News* until it was banned by Mr Mugabe in 2003 after its presses were blown up in 2001, and Trevor Ncube, a Zimbabwe-born former chief executive of South Africa's M&G Media group, who is setting up a competitor, called *Newsday*. Even the weekly *Financial Gazette*, widely believed to be owned by Mr Mugabe's ridiculed central-bank governor, Gideon Gono, may be planning a daily version. But none has yet been launched, because the Zimbabwe Media Commission has yet to be set up as agreed under the power-sharing deal.

Some say the commission may start licensing new (or old) publications next month. But Mr Mugabe is plainly loth to give rein to a free press. Radio and television are entirely in state hands, yet Zanu-PF must pay lip service to the unity agreement. Mr Ncube says *H-Metro* has been rushed into print to try to seize the market ahead of its inevitable liberalisation. "They are panicking," he says.

Guns in Africa

Out of control

Sep 10th 2009 | NAIROBI
From The Economist print edition

A bunch of governments is trying to stem the flow of lethal weapons

THE UN reckons there are some 500m small arms in circulation around the world. At least 70m are Kalashnikovs. The Soviet-designed automatic assault rifle, the Avtomat Kalashnikova, was first manufactured in 1947 (hence its commonest version, the AK-47). Its compactness and durability have made it Africa's killing weapon of choice since the 1980s, despite its inaccuracy. These days, the continent has all of the score of Kalashnikov variants, including the AKM, the Chinese Type 56, and the Serbian Zastava M70.

Reuters



Lethal toys for boys

Only a small share of the thousands of hapless Africans killed every year by Kalashnikovs die in war. Most are victims of the police, robbers, cattle raiders and tribal skirmishes. In an attempt to make it harder for organised criminals to arm themselves, and in a nod to global counter-terrorist efforts, a group of ten eastern and central African countries, including Ethiopia, Rwanda and Uganda, which owe their liberation movements partly to the Kalashnikov, has agreed to harmonise gun laws. It has promised longer sentences for people who carry guns illegally and new electronic marking of state-owned weapons in the hope of cutting the number of Kalashnikovs seeping into the black market, where they are bought more cheaply than anywhere else in the world. The going rate in Somalia and Sudan is around $400, much cheaper than in Asia.

Police chiefs from this new African club of countries paraded their claimed success in curbing the small-arms trade by inviting journalists to watch piles of confiscated rifles being burnt. But that is unlikely to hurt the shadowy, highly profitable illegal trade. New Kalashnikovs keep flowing into Africa. Only a fraction gets confiscated.

Last year a hijacked Ukrainian ship with a cargo of tanks bound for South Sudan was also carrying 10,000 AKs and ammunition, according to the Small Arms Survey, a Swiss-based pressure group. British intelligence last month flagged up what may have been another Ukrainian attempt to export Kalashnikovs to Africa from its Soviet-era stockpiles. It is easy to sell the weapons once they reach Africa. Borders are porous. Corruption eases the flow. Arms dealers can readily buy forged licences and paperwork from officials.

The Kalashnikovs' popularity puts a premium on the 7.62 x 39mm calibre bullets, which often cost more than those used in rifles such as the German G3 and the old British Lee-Enfield. African policemen and soldiers are often tempted to sell the bullets illegally, since they can each fetch as much as $1 or more. Tracking the ammo is tricky. It is seldom stamped, its provenance often even murkier than that of the guns.

In the harsh Turkana region of northern Kenya a British small-arms specialist, James Bevan, found Kalashnikov cartridges from 25 countries and 51 factories. Half of them, he reckons, had been bought or pilfered from state armouries.



America and eastern Europe

End of an affair?

Sep 10th 2009
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The Atlantic alliance is waning in Europe's east

Illustration by Peter Schrank



AFTER two decades of sometimes fervent Atlanticism in the ex-communist world, disillusionment (some would call it realism) is growing. At its height the bond between eastern Europe and America was based, like the best marriages, on a mixture of emotion and mutual support. The romance dates from the cold war: when western Europe was sometimes squishy in dealing with the Soviet empire, America was robust. When the Iron Curtain fell, ex-dissidents and retired cold warriors found they had plenty in common. America pushed for the expansion of NATO, guaranteeing the east Europeans' security. In return, ex-communist countries loyally supported America, particularly in providing troops for wars in Iraq and Afghanistan.

That relationship is now looking more wobbly. A new poll (see chart) by the German Marshall Fund, a think-tank, shows that western Europe is now much more pro-American and pro-NATO than the ex-communist east. Until last year, the eastern countries swallowed their misgivings about George Bush, while the west of the continent writhed in distaste at what many saw as his administration's incompetence and heavy-handedness.

Like, or love?
US president approval ratings
% of those surveyed

2008, Bush | 2009, Obama

0 20 40 60 80 100

Germany
Britain
Romania
Poland

Source: German Marshall Fund, Transatlantic Trends Survey 2009

The ascent of Barack Obama has boosted America's image in most countries, but only modestly in places like Poland and Romania. Among policymakers in the east, the dismay is tangible. In July, 22 senior figures from the region, including Vaclav Havel and Lech Walesa, wrote a public letter bemoaning the decline in transatlantic ties.

One reason is that the Obama administration is rethinking a planned missile-defence system, which would have placed ten interceptor rockets in Poland and a radar station in the Czech Republic, in order to guard against Iranian missile attacks on America and much of Europe. That infuriated Russia, which saw the bases as a blatant push into its front yard. Changing the scheme—probably using seaborne interceptors—risks looking like a climb-down to suit Russian interests.

Poland is also worried that a promised battery of Patriot air-defence missiles, originally to protect the interceptors, may now be only a temporary loan of dummy rockets for training purposes—"just a sales exercise", says an official in Warsaw, crossly. America says it never intended to station real rockets there permanently.

The administration also botched its participation in Poland's 70th anniversary commemoration of the start of the second world war on September 1st. Other countries, including Russia and Germany, sent top people. America, initially, offered only a retired Clinton-era official. William Perry, who was a notable sceptic about NATO expansion. After squawks of dismay, Jim Jones, the national security adviser, went too. But Poles sensed a snub.

Another sore point concerns leaks from America suggesting that Poland, Romania and Lithuania hosted secret bases for the "rendition" and interrogation of terror suspects. All three strongly deny this, but in at least some voters' eyes, the American alliance is now tainted with connivance in kidnap and torture, followed by cover-ups. The next time American spooks want some secret help, they may find their allies less handy, an official notes.

NATO's credibility is under scrutiny too. New members say that their voters will not support out-of-area expeditions—the alliance's big focus just now—unless it is properly defending the home front against any threat from Russia. It does not help that Russia and its ally, Belarus, have just started a large joint military exercise, ostentatiously named "Zapad" (West).

At a big NATO advisory conference in Brussels in July, east Europeans were aghast to hear one prominent German academic describe Article V, the alliance's cornerstone collective-security guarantee, as a "fiction". In the event of a Russian threat, say to the Baltic states or Poland, would NATO act or merely consult? A worried easterner describes the alliance as "like an 18th-century Polish parliament, hostage to its most irresponsible member".

NATO is trying to soothe those fears. A committee that writes the threat assessment has rejigged its view on Russia. Contingency planning, once taboo, is taking shape. The Obama administration has been more vigorous on this front than its predecessor. But what Poland wants, especially if the missile-defence base is cancelled, is practical preparations, such as regular manoeuvres, and fuel and ammunition stockpiles.

Part of the problem is the much-publicised attempt by the Obama administration to "reset" relations with Russia. Few in eastern Europe object to that in principle. But many worry about how it will work in practice. Will Russia demand greater sway in the region in return for help, say, in squeezing Iran? The State Department has tried hard to reassure America's allies. But the official at the National Security Council directly responsible for Europe, Liz Sherwood-Randall, used to work for Mr Perry and shared his views on NATO expansion. East European officials flinch when her name is mentioned.

Admittedly, America has many other bigger problems than its relations with eastern Europe. Self-importance and public whingeing do not win arguments in Washington. The east Europeans may have been naive in their dealings with America in the Bush years. But for all that, even people inside the Obama administration agree that it could do better.

Germany's energy debate

Nuclear power? Yes, maybe

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Angela Merkel's promise to keep nuclear power is turning radioactive

AP



Cocking a snout at nuclear power

REFLECTING the morning sun like a lake of black ice, the solar panels in the wild forests of Brandenburg's border with Poland offer a glimpse of a German dream of a future built on clean energy. Here, at Lieberose, the world's second-largest photovoltaic power plant captures morning light to produce enough electricity for a town of about 15,000 homes. Gleaming rows of solar cells like these, lazily turning windmills and other renewable sources already provide about 15% of Germany's electricity, making the country a leader in both wind and solar technology.

But impressive as such achievements have been, Germany faces contentious energy choices, and none more so than over the future of 17 nuclear power plants, some aged and prone to breakdowns, that provide almost a quarter of the country's electricity. Their fate has been one of the few emotive issues in the campaign for federal election on September 27th.

In 2000 a previous coalition of the Social Democratic Party (SPD) and Greens decided to ban construction of new nuclear power plants and gradually to phase out existing ones by 2022. That may all change soon if the Christian Democratic Union (CDU), led by the chancellor, Angela Merkel, is able to form a government with the liberal Free Democrats (FDP). Ms Merkel has pledged to extend the lives of some nuclear plants by up to 15 years; the FDP is keen to build new reactors.

One reason to keep reactors humming is money. Nuclear power plants are horribly expensive to build, but are then relatively cheap to run. Christopher Kuplent of Credit Suisse, an investment bank, reckons that German power companies could generate extra profits to the tune of €25 billion ($36 billion) before tax if they do not have to hit the off button. German electricity prices, which are among Europe's highest, would probably also drop. That would please big businesses which have been lobbying to extend the lives of the plants.

Claudia Kemfert of DIW, a think-tank in Berlin, argues that keeping the nuclear plants going would buy time and produce the money needed for Germany to increase the share of energy coming from renewable sources. If utilities were allowed to run nuclear power plants for longer, they would probably have to share their gains, perhaps by having to pay a windfall tax or agreeing to finance investments in renewable energy, says Mr Kuplent.

The economic argument may make sense, but it will be hard to sell to a sceptical public. Opposition to nuclear energy has, if anything, hardened of late. A poll in February found that almost 60% of respondents wanted to reverse or slow down the phase-out. But a more recent one in July, just after an accident shut the Krümmel nuclear plant for the second time in two years, showed a sharp swing: 31% of

Germans wanted the phase-out maintained, and a further 32% wanted it speeded up. Just 17% thought Germany should stay in the nuclear business.

The convoluted politics of the outgoing grand coalition have also played their role in dampening public support. The SPD's Sigmar Gabriel, the environment minister, has used his position to campaign against nuclear power. He accuses Ms Merkel of being "irresponsible" and has issued a stream of revelations about, for instance, safety breaches at Asse, a nuclear-waste storage site, and the leaky condition of Gorleben, a salt dome intended to house high-level waste for thousands of years.

For all the heat of debate, extending nuclear plants would delay Germany's difficult choice by only a decade at best. About half of its energy comes from burning coal, a prolific producer of greenhouse gases. Even with the growth of renewable energy, the intermittent nature of the sun and wind mean these sources cannot replace nuclear power without costly investments in energy storage and transmission. Replacing nuclear plants with coal-fired ones seems equally far-fetched.

To keep the lights burning, Germany may ultimately have to choose between missing its targets to reduce greenhouse gasses or becoming more beholden to Russia for natural gas. That debate could turn radioactive.

French criminal justice

A delicate judgment

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Nicolas Sarkozy wants to reform Napoleon's investigating judges

"NO HUMAN authority", wrote Balzac, "can encroach upon the power of an investigating judge; nothing can stop him; no one can control him." Invented by Napoleon, the French *juge d'instruction*, or investigating judge, has extraordinarily wide-ranging judicial powers. These figures have helped to expose big corruption scandals and developed a reputation for robustness against terrorists, but they have also produced some miscarriages of justice. Two centuries after the role was devised, President Nicolas Sarkozy now wants to end it, opening a complex debate.

The function of the investigating judge, "which has practically no equivalent in Europe, is no longer adapted to our times" and should be scrapped, according to the report of an official commission on criminal-justice procedures published this month. Michèle Alliot-Marie, the justice minister, is working on a draft law to this effect, to be presented in the new year.

France's 600-odd investigating judges, a central feature of its inquisitorial system, can put suspects under formal investigation, order wiretaps, raid and search premises, confiscate documents, and summon and interrogate witnesses. On top of this, often after years of investigation, they also weigh the evidence, and decide whether to send a suspect for trial.

With their huge freedom to dig and probe, feisty investigating judges have uncovered some of France's biggest political and financial scandals. They exposed the "fake jobs" affair at the Paris town hall, dating to Jacques Chirac's term as mayor; several of his close former colleagues have been found guilty, and the ex-president is still under investigation. The judges spent years pursuing the Elf-Aquitaine corruption scandal, in which several top French oil executives ended up behind bars. They are behind a smear-campaign inquiry, known as the Clearstream affair, in which Dominique de Villepin, a former prime minister, is about to be tried in court and Mr Sarkozy is a civil plaintiff.

Yet some investigating judges have also been criticised for misusing their own powers. The most infamous case concerned the suspected sexual abuse of children in Outreau, a suburb of Boulogne-sur-Mer. Six innocent people were wrongfully found guilty of running a paedophile ring, and spent years behind bars, before being acquitted on appeal in 2005; several other innocent people spent years in pre-trial detention. A parliamentary inquiry later underlined the need for young, inexperienced judges not to work alone.

France has already curbed its investigating judges' powers. They can no longer, for example, decide alone whether to put a suspect in pre-trial detention; that is now up to a special judge. Thanks to the Outreau inquiry, they will soon be grouped together in bigger offices, and work in teams.

Yet, as the commission points out, the job still "combines the functions of a judge with those of an investigator" and as such operates with "fundamental ambiguity". Mr Sarkozy, who announced in January that he wanted to change the role of investigating judges, is particularly keen to strengthen the rights of the defendant and the presumption of innocence.

Under the commission's proposals, all investigations would be carried out by public prosecutors. Investigating judges would be transformed into judges only, answerable—as now—to the independent Conseil Supérieur de la Magistrature. They would have powers to supervise, authorise or block certain steps carried out by the investigators, such as wiretaps, searches or pre-trial detention, but would not conduct inquiries.

Opponents of this change, including the main magistrates' union, fear that investigations will become toothless if they come under the ultimate control of the justice ministry, to which the public prosecutor answers. Even the commission was not united on the issue. Eva Joly, the former investigating judge on the Elf case and now a green euro-deputy, has said the move would be an attempt at "preventing investigations that trouble political power".

Turkey, Cyprus and NATO

Fogh in the Aegean

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NATO's secretary-general seeks better ties with the EU

Reuters



Fogh Rasmussen under Turkish scrutiny

THE (perhaps vain) hope of Anders Fogh Rasmussen, NATO's newish secretary-general, when he visited Greece and Turkey recently was to get these hostile NATO members to set aside their longstanding rivalry so as to improve co-operation between the alliance and the European Union. Turkey objects to this because of a Greek and Cypriot block on its own participation in EU military planning, and on its putative membership of the European Defence Agency. As Mr Fogh Rasmussen complains, this means NATO cannot formally protect EU policemen in Afghanistan. "It's a security issue. It's absurd," he says.

Turkey, which has NATO's second-largest army, fiercely opposed Mr Fogh Rasmussen's candidacy for NATO's top job because he was Denmark's prime minister during the Prophet Muhammad cartoon crisis and because the Danes have refused to ban Roj TV, a satellite channel run by the outlawed Kurdistan Workers' Party (PKK) that is beamed out of Denmark.

Mr Fogh Rasmussen's choice of Ramadan as the time to visit Turkey was calculated to ease Muslim anger. He took part in a lavish *iftar* (breaking of the fast) organised by the Turkish prime minister, Recep Tayyip Erdogan. It was, says Mr Fogh Rasmussen, "a clear manifestation" of his respect for Islam. Yet his Turkish hosts remained unswayed. His request for combat troops for Afghanistan seems to have been rebuffed, as were his entreaties that Turkey allow Cyprus to join NATO. But at least he wangled a commitment of more Turkish troops to work on reconstruction projects in Afghanistan.

Mr Fogh Rasmussen concedes that, unless and until the Cyprus dispute is resolved, there is little chance of a big improvement in NATO's relations with the EU. Turkey does not recognise the Greek-Cypriot government. Its continuing refusal to open ports and airports to Greek-Cypriot carriers may yet lead to a freezing of its EU membership negotiations later this year.

Mr Fogh Rasmussen wants pragmatism to prevail because the "lives of our forces are at risk". He suggests that "the EU must accept a security arrangement with Turkey, and NATO a security arrangement with Cyprus". Yet Greece recently protested that eight Turkish fighter jets had flown dangerously close to a Rhodes-bound Greek passenger aircraft. Western diplomats talk of a marked escalation in dogfights between Turkish and Greek pilots over the Aegean. Another NATO crisis in the making?



Spain's growing budget deficit

Taxing times

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The prime minister plans to raise taxes to restore the public finances

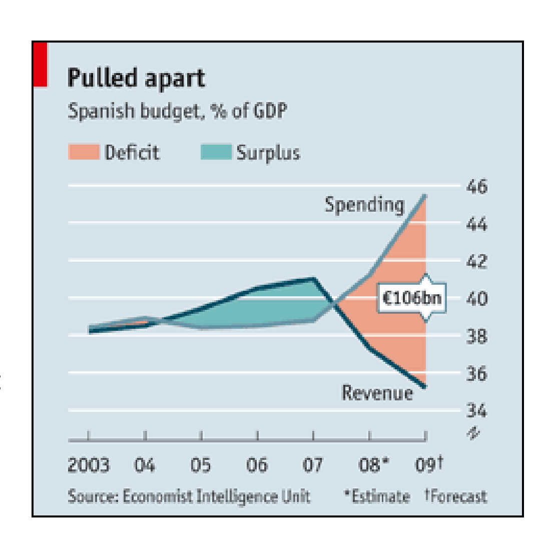
FIRST it was spend, spend, spend. Now it is tax, tax, tax. As Spain's budget deficit soars and economic recovery remains elusive, the Socialist prime minister, José Luis Rodríguez Zapatero, has made clear how he expects to start balancing the books. "I am going to ask for a share of people's incomes out of solidarity and to meet the demands of the most needy," Mr Zapatero told parliament on September 9th.

He said the 2010 budget would aim to raise overall taxes by 1.5% of GDP, which should earn the government about €15 billion ($22 billion). Mr Zapatero did not spell out how he would do this, leaving the matter to negotiations with parties whose support he needs to get the budget passed.

Still, Mr Zapatero is performing a U-turn. In previous years he cut the top rate of income tax, slashed company tax and brought in a populist €400 ($560) annual rebate for all Spanish taxpayers. But that was when Spain was booming. The latest data shows that GDP is shrinking by 4.2% annually. Spain also has Europe's worst unemployment, at 18% and climbing.

Respite will not come soon. Spain's recession, made worse by a burst housing bubble, is different from those of other European countries. Some economies are already starting to look up, but Spain's will not recover for another year. The construction industry is in tatters and, with hundreds of thousands of unsold new houses, is not about to recover.

An €8 billion public-works stimulus combined with a dramatic fall in revenues has blown an enormous hole in the public accounts (see chart). This year's budget deficit is expected to be around 10% of GDP. Yet Mr Zapatero has promised extra money to everyone, from regional governments to the long-term unemployed. Next year will see an extra €5 billion given to town halls.



Unless he is prepared to cut spending, Mr Zapatero can only keep his promise to cut the deficit to 3% of gdp by raising taxes. "I have always thought of fiscal policy as an instrument that should respond to changes in the state of the economy," he said recently. Mr Zapatero will probably scrap his income-tax rebate, or most of it. But he is cautious about raising income tax. The public-works minister José Blanco, a Socialist heavyweight, floated the idea of higher taxes for big earners during the summer, but the prime minister firmly squashed it.

The main target, apart from obvious things like alcohol, tobacco and petrol, is likely to be capital-gains tax. This was set at 18% in 2007, far below a top tax rate on earned income of 43%. Investors are anxiously waiting to hear how much they will have to pay. The opposition People's Party (PP) which wants tax and spending cuts, mocks such moves. "No tax rise is capable of covering up the hole you have made," the PP leader, Mariano Rajoy, told the prime minister in parliament.

Mr Zapatero shows little appetite for long-term spending cuts of the kind that countries such as Britain are starting to think about. He looks as if he is storing up problems for the future.

Spain's judiciary

Judge Garzón in the dock

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One of the world's most famous judges is questioned

EPA



Always in the limelight

FOR some he is like Don Quixote, the pursuer of noble if unrealistic causes. For others he is more like Torquemada, the infamous head of the Spanish Inquisition. Still more see him as a genuine hero. Whatever the case, Spanish passions were bound to be raised by the prospect of Baltasar Garzón, the crusading magistrate with a rare international profile, being grilled in court over his own behaviour.

Judge Garzón spent four hours being quizzed by a Supreme Court justice on September 9th over his investigation into abuses committed by the regime of the late Spanish dictator, General Francisco Franco. A private prosecution alleges the judge knowingly twisted the law to push his case despite an amnesty passed after Franco's death. One of the many oddities of the case is that he was pursuing ghosts: the 34 people he named as suspects were dead. General Franco himself died in 1975, and the newly democratic country tried to forget him.

Judge Garzón, though, likes pursuing dictators. He nearly had Chile's General Augusto Pinochet extradited from Britain to Spain to face charges of genocide in 1998. He has gone after military regimes from other Latin American countries. Along the way he has tested—some would say stretched—international human-rights law. One triumph was the jailing in Spain of Adolfo Scilingo, a navy captain in Argentina's former junta who admitted throwing drugged prisoners out of aircraft into the sea.

Judge Garzón's critics complained that he chased foreign dictators but ignored Spain's own past. Last year he decided to act. He declared himself competent to investigate the disappearance of some 114,000 people during and after a three-year civil war that started with a 1936 uprising by Franco and others. Then he named 34 former generals and ministers suspected of crimes against humanity. Although Judge Garzón later passed the case down to provincial courts, a right-wing pressure group sued him. His appearance in the Supreme Court was the first stage in an uncertain process that could, in theory, end with his suspension.

Angry supporters outside the court claimed this was revenge by old Francoists. Spain's conservative People's Party, which is at odds with the left-leaning Judge Garzón, pointed out that he was as duty-bound to obey the country's laws as anyone else. Perhaps the least surprising thing was to see his name in headlines yet again.

Charlemagne

Germany's oddly vapid election

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Why Germany is dangerously complacent about its social-market model

Illustration by Peter Schrank



AT A guess, the target audiences for visionary economic thinking and oompah music do not overlap much. So one should not be too hard on Angela Merkel for the smug and introspective election address she delivered in a Bavarian beer tent on September 7th during a campaign visit to the "Keferloh Monday" country fair. Flanked by musicians in lederhosen, the German chancellor told her audience that the economic crisis had proved the superiority of the country's post-war model, in every way. Germany was not like America where 50m people had no health insurance, she told the crowd. From Konrad Adenauer to Helmut Kohl, wise German leaders had balanced freedom with security, and wealth with social solidarity.

If the global financial crisis had reached Germany, that was the fault of greedy bankers. Europe would demand tough new rules in financial markets. And Germany was and would remain an export champion, Mrs Merkel assured her audience: indeed, it should export its "social market economy" to the world.

Bavaria is a tradition-minded place. But the problem is that Ms Merkel has been delivering similarly vapid speeches around the whole country. The main slogan of her Christian Democratic Union (CDU) is the boosterish, content-free "We have the power", with the "We" superimposed on a German flag.

The CDU is set to win the elections on September 27th though the polls are tightening. Yet she did not mention her chief opponent (and current coalition partner), Frank-Walter Steinmeier, by name; nor did she really attack the policies of her rivals on the left, though she would rather end her awkward "grand coalition" with Mr Steinmeier's Social Democrats (SPD), and form a government with the pro-business Free Democrats (FDP). Christian Schlemmer, a farmer listening to Ms Merkel's speech, was unworried by the lack of partisan fireworks. If voters were angry, he said, it was with the banks, "not the politicians".

All this makes for a funny sort of German election, and one that has consequences for the wider European Union. A year after the credit crunch reached Europe, the focus of EU leaders has turned from crisis management to planning for the future. Clever, bold ideas are sorely needed. Europe had much to ponder before the crisis, from ageing populations to energy security. The crisis has only increased the urgency of some existential questions. For instance, is a "European model" based around open borders, free trade and generous welfare systems sustainable in a globalised world? The crisis has exposed acute new questions, such as how to marry Europe's cross-border single market for finance with the reality that only

national governments can and will step in when things go wrong. Any proper European debate will need to hear Germany's answers to those questions. Yet its politicians are shunning real debate—until election day at least.

The German people are in a "very unusual" mood, says Werner Weidenfeld of the University of Munich. Past elections involved clashes of ideas and angry finger-pointing between the big parties. In the 1970s, recalls the professor, voters turned out in record numbers to cast their verdicts on Willy Brandt's entente with the Communist east. In television debates voters used to ask leaders about the "society of tomorrow". Today, they have "zero" interest in such lofty questions, inquiring instead about optimal levels for health-insurance contributions. In the depths of the biggest economic crisis in 70 years, many Germans feel that their country has weathered the storm well.

There are several plausible explanations for Germany's undramatic election. One is political calculation. The two biggest parties have been in coalition for four years, and can hardly savage their own record. Because Mrs Merkel looks set to remain as chancellor, the SPD and FDP have been reduced to painting each other as dangerously extreme coalition partners for her.

More positively, Germans have grounds to feel their government acted to protect them when the crisis broke. Short-time work schemes have preserved many jobs. A car-scrapping scheme, much copied elsewhere, kept vehicle sales afloat and thrilled car-mad German voters. The fear is that big problems have been postponed until after the elections. Because of skills shortages before the crash, firms did not want to shed staff, says Kai Carstensen of Ifo, a research institute. But short-time schemes are expensive: in the first quarter of 2009 unit labour costs in industry rose by about 25%, thanks to subsidies paid to idled workers. Businessmen admit in private that they have postponed sackings in order to avoid boosting the left-wing vote, says Prof Weidenfeld. In Brussels senior EU officials fret that horrors still lurk in parts of Germany's banking system: nobody knows, because the German government has kept the real situation secret.

Don't be so smug

Psychology helps explain Germany's complacency. It is easy for voters to hear that financial turmoil was brought about by un-German greed. A sense of relief also accounts in part for Germans' calm in this economic storm, when recessions usually leave them so gloomy. Nobody knows if the country is over the worst, but early fears of job losses were not realised. Add *Schadenfreude* to the emotional mix: Germans would have to be saints not to cheer, just a bit, the crisis engulfing rivals like Britain, whose leaders used to sneer about continental stagnation.

Alas, this crisis is deeper than German politicians admit. Germany's social-market model still faces severe tests. It is specious to boast that it should be exported widely, even within Europe: Germany's combination of wealth, wage discipline and post-war obsession with consensus is pretty unusual. Cosy, smug introspection may be right for a Bavarian country fair. Elsewhere, though, it is time for Germany's leaders to debate real ideas.

Economist.com/blogs/charlemagne



The ethics of Labour's foreign policy

Angels and demons

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The release of the Lockerbie bomber has revived scepticism about the government's allegedly moral approach to the outside world

Illustration by David Simonds



IT TOOK a speech of fewer than 1,300 words to make a rod for the government's back that has been gleefully wielded by its critics for the past 12 years. Soon after the Labour Party won power in 1997, the late Robin Cook, then foreign secretary, outlined his priorities for Britain abroad. The most eye-catching was a pledge to heed ethics as well as interests in shaping foreign policy. It quickly became Labour's equivalent of the "back to basics" speech given by John Major, the former Conservative prime minister, four years earlier: a statement of moral intent undone by successive failures to live up to it.

The latest of Labour's perceived ethical lapses in foreign policy involves Abdelbaset al-Megrahi, the Libyan convicted of the 1988 Lockerbie bombing. Some suspect the government encouraged the recent release of Mr Megrahi by the Scottish administration to preserve commercial interests in Libya rather than just the country's recent help in fighting terrorism (though ministers deny exerting pressure at all). On September 6th it was revealed that Gordon Brown, the prime minister, declined to ask Libya to compensate British victims of terrorist attacks by Irish Republicans, who had used Libyan-supplied explosives.

Nor has Labour's support for the British arms industry been a triumph for moralpolitik: weapons were sold to Indonesia's authoritarian regime and a bribery investigation into a lucrative sale of fighter-jets to Saudi Arabia was halted. Such events have fed the view that the government's ethical pretensions have never amounted to much and were naive to begin with.

Despite all this, the assumption that Labour promised much on ethics abroad but delivered little seems overdone on both counts. Mr Cook's pledge was nothing like as grand as its reception suggested. He aspired not to an "ethical foreign policy", as is often thought, but to a foreign policy with "an ethical dimension", and even this was only the fourth of his priorities—security and prosperity were the main goals. Indeed, although he had made his name attacking the previous Conservative government over the arms-to-Iraq scandal, his party in opposition was more anxious to stress its credentials as hard-headed custodian of the national interest. The pacifism of its electorally ruinous 1983 manifesto was renounced at every turn.

And Labour's early record of ethical policies was substantial. Much more was spent on foreign aid. Annual human-rights reports on the government's foreign policy were inaugurated. The granting of export licences to arms manufacturers became more transparent. Arms sales to regimes that might use them for internal repression or external aggression were banned—and though this rule was broken when the new government signed off on an existing order of jets to Indonesia, the sale was suspended in 1999 when it became clear that the Suharto regime was repressing the East Timorese. Labour also supported the Kyoto protocol, the International Criminal Court and The Hague tribunal investigating war crimes in the former Yugoslavia.

Mr Cook was not adumbrating military interventions when he spoke of ethics, but these are what Labour's foreign policy will largely be judged by. Cynics brandish Tony Blair's militarism as *prima facie* evidence that his morals were only for show. The former prime minister fought five wars: the bombing of Baghdad in 1998, the avowedly humanitarian interventions in Kosovo and Sierra Leone in the following two years, and the larger conflicts in Iraq and Afghanistan in recent years.

The good fight

But Labour has half a good story to tell. The Kosovo and Sierra Leone missions are uncontroversial in Britain now—a testament both to their success and to the bigger, bloodier wars that would come later. Kosovo in particular was a landmark: a war which, without UN support, breached the sovereignty of a state for explicitly moral reasons. Mr Blair's "Chicago Doctrine" was an attempt to insert a norm of ethical intervention into a world long dominated by the principle of state sovereignty. The "responsibility to protect", an evolving humanitarian concept embraced by the UN, owes something to his words and deeds around the turn of the millennium.

If the government's ethical ambitions were largely met in its first two years, and exceeded in the next two, they ran aground in Iraq. Though more a war of choice than Afghanistan, a moral case was seldom made for it (the security threat posed by Saddam Hussein was the professed *casus belli*). The bloodletting it unleashed has undermined any moral case anyway. Mr Cook, an architect of the Kosovo mission, resigned in protest at the war. His former aide, David Clark, wrote that Iraq shattered the "post-Kosovo consensus" for ethical intervention. Yet however dubious the official case for war and unforgivable its execution, Mr Blair seemed guiltier of taking his missionary zeal too far than of narrowly pursuing British interests. When David Cameron, the Tory leader, calls him "a liberal interventionist without a handbrake" he is at least honouring his motives.

Ultimately, Labour's mistake may have been not so much invoking ethics (something British statesmen such as Lord Palmerston often did during the country's imperial prime in the 19th century) as failing to define them. It is not obvious whether the moral good is served by seeking peace above all else, or risking bloodshed to remove a despot. (Neither is it clear whether an ethical foreign policy would favour stateless Palestinians or a terrorised Israel surrounded by enemies—Mr Blair was regularly attacked for siding with the latter.)

The two main ethical strands of Labour's foreign policy—the expansion of aid led by Mr Brown and the humanitarian interventions pursued by Mr Blair—add up to a big change from the Major era. Some Tories wonder why Labour politicians do not make the case for their ethical achievements. True, they would have to explain myriad compromises and abdications along the way. But some of these, such as striving to stay on good terms with Libya for reasons of economics as well as security, are possible to defend. Overall, it seems a far from damnable record from a government which never promised that justice would be done though the heavens fall.

Military exports

No farewell to arms

Sep 10th 2009
From The Economist print edition

The defence industry comes out fighting

Eyevine



"DIPLOMACY without arms," said Frederick the Great, "is like music without instruments." A former Tory defence secretary, Malcolm Rifkind, quoted him this week in defending the sale of arms to countries thought likely to use them responsibly.

They presumably include the 45 or so states that sent delegations on September 8th to the world's biggest arms-fest, the Defence Systems & Equipment International (DSEI) show in London. Libya and Saudi Arabia were among those invited.

British governments have rarely blanched at armaments as a staple of trade. The Department for Business, Innovation and Skills has its own Defence & Security Organisation to promote arms exports, with palpable success: Britain is one of the world's biggest exporters of defence goods and services, usually ranking after America, with a market share averaging 21% over the past five years. Orders usually hover just over £4 billion ($6.6 billion) a year, though they were boosted in 2007 to £9.7 billion by a big order from Saudi Arabia for fighter-jets (see chart). These days the big buyers are Gulf Arab states, Malaysia, Thailand and Singapore. The Brazilian navy is almost entirely British-equipped, though some of the kit is second-hand.



But arms-industry lobbyists are worried by the lack of clarity on future defence spending in Britain, since sales to their own armed forces are a springboard into foreign markets. They argue that with the decline of the financial sector as a money-spinner the British economy needs rebalancing—naturally, in favour of their own world-beating industry.

This month the Defence Industries Council (DIC), a lobby group, published a study that put defence squarely among the sectors worth investing in. A £100m government splurge on the defence industry, it calculated, would generate £227m in economic impact—less than the same slug of money for construction or carmaking would produce, but above telecommunications, pharmaceuticals and indeed banking. Defence firms provide high-quality jobs, use bags of technology and spend heavily on research and development, they point out.

So the lobbyists will have found some cheer on September 7th when Liam Fox, the shadow defence secretary, said a future Conservative government would strive to increase Britain's share of global defence exports, using them as "a foreign-policy tool". Britain has managed to enmesh its own servicemen in the national export drive. At trade fairs such as the DSEI, loyal British squaddies in combat dress on secondment to the business department do their bit to support British exports, explaining their equipment to all-comers on selected company stands.

The Ministry of Defence has its own Defence Suppliers Service, which helps companies, particularly small and medium-size enterprises (SMEs), to win British military-procurement contracts. There are around 9,000 British firms in defence and security, and more of them are SMEs than the sector can muster in France, Germany, Italy, Spain and Norway combined, according to the DIC. Sales look set to grow, even if big wars decline, as some think likely. Oil states need to protect their installations and ships from terrorism and piracy; there is high demand for sophisticated kit for those in "dismounted close combat", including thermal vision, body armour and unmanned aerial vehicles. Music to Frederick's ears, perhaps.

The airline bombers

Bang to rights

Sep 10th 2009
From The Economist print edition

Convictions at last in a foiled Islamist plot, but other terrorist threats remain

FOR the past three years, travellers around the world have had to surrender their drinks, toothpaste and shampoo to merciless airport-security guards. Irate passengers swear at the endless queues and inconvenience, while conspiracy theorists mutter darkly that security firms are in cahoots with the duty-free shops on the other side of the barrier.

On September 7th flyers were reminded of the real reason for the restrictions: three British men—Abdulla Ahmed Ali, Assad Sarwar and Tanvir Hussain—were convicted of conspiring in 2006 to bomb seven transatlantic passenger flights, using liquid explosives hidden in drinks bottles. Five others were tried with them. One, Umar Islam, was convicted of conspiracy to murder, but the jury was unable to reach a verdict on three others. The fifth, Donald Stewart-Whyte, was cleared altogether.

This was not the first time the bombers had faced such charges. Arrested in August 2006, the men were tried in 2008. That appearance led to three convictions for conspiracy to murder, with the jury unable to decide whether the men had intended to blow up the planes specifically.

Prosecutors then were not helped by the fact that a twitchy American administration had pushed the Pakistani government into arresting Rashid Rauf, a suspected liaison between the plotters and al- Qaeda terrorists, while Britain's coppers and spies were still gathering information. The policeman in charge of the investigation—who had been confident enough to take a holiday in Spain—had to rush home to supervise a string of hasty arrests. But a stronger case was made at the second trial. E-mails among the bombers and their contacts in Pakistan, recovered from servers in America, helped to persuade the jury to convict, say prosecutors.

The result vindicates Britain's security services, who mounted a large surveillance operation to foil a plot that, if successful, would have been the biggest terrorist attack in British history—"our UK 9/11", says Andy Hayman, head of specialist operations at the Metropolitan Police at the time. The usefulness of the e-mails may also strengthen the hand of those who, like Sir Ken Macdonald, formerly Director of Public Prosecutions, want Britain to admit domestic intercept evidence in court, as many countries do.

The government may hope that the convictions will bear fruit of another sort too. A week ago, Eric Joyce, an MP, warned as he resigned as aide to the secretary for defence that the public was tiring of the claim that fighting in Afghanistan's Helmand province keeps the streets safe in Britain. Confirmation that the would-be bombers really did have airborne murder in mind (they trained, like so many, in Pakistan, which shares a porous border with Afghanistan) might make such claims easier to swallow, at least for a while.

Yet only a day later, attention was diverted by events closer to home. Police in Northern Ireland discovered a 600-pound bomb in County Armagh, which was thought to be the work of a dissident republican group. In January another bomb was found near an army base in County Down; in March two soldiers were killed when gunmen attacked a base; and in May bomb components were discovered in County Fermanagh.

Also on September 8th Neil Lewington, a white supremacist, was jailed in England for planning a terrorism campaign against the "non-British". Even as Islamist terrorism grabs the headlines, more familiar varieties cling stubbornly to existence. It would be a brave man willing to bet where the next attack will come from.

Politics and the spending squeeze

The chancellor's eyebrows

Sep 10th 2009
From The Economist print edition

Labour's change of heart may prompt the debate that is sorely needed

Reuters



TWICE, when he was chancellor of the exchequer, Gordon Brown fought and won general elections by contrasting Labour "investment" (his preferred term for spending) with Tory "cuts" (his preferred term for smaller increases in spending than he was planning). He pushed that line again as prime minister, even while the public finances lurched ever more sickeningly into the red. Now, as the general election draws closer (it must be held by June 3rd), he is finally having to change his line.

The economy may be emerging from recession—manufacturing output climbed for the second consecutive month in July and activity in the services sector rose again in August, according to the latest survey of purchasing managers—but the need to trim the budget deficit once a recovery is entrenched is pressing. Even a contortionist could not make Mr Brown's electioneering position on spending fit the budget arithmetic of his own chancellor, the heavily-eyebrowed Alistair Darling. In April he set out a strategy, of sorts, for plugging the gaping hole in the public finances.

The eight-year plan entails increases in taxes, including a controversial move to tax high earners at 50% as early as next year. But most of the reduction in the deficit during the next parliament will come from a clampdown on spending, such that in real terms it will contract marginally during the three fiscal years to 2013-14. Capital spending in particular is to be slashed.

That will make sloganeering about Labour's commitment to "investment" even hollower than before. But quite apart from the Treasury's awkward numbers, Mr Brown's approach is failing the test of public opinion. In a poll by Populus in July, 81% of people said that significant cuts in government spending were inevitable after the next election, whoever wins.

After discussions with Mr Darling over the summer, the prime minister is now adopting a more credible stance. True, the word "cuts" remains taboo. Instead the two prefer to talk about "tough choices" and "setting priorities", as in a speech the chancellor gave this week in Wales. Even so this is an advance on the earlier pretence that Labour, unlike the Tories, was not poised to slam the brakes on spending. Mr Darling was not afraid to talk about cutting costs and further reform of the public services. And he said that "we need constantly to test the limits of what government can do best—and where to step back".

In an encouraging sign, Moody's, a credit-rating agency, indicated this week that it did not expect to downgrade Britain's prized triple-A borrowing status despite its ballooning debt—in effect because the next government would do the right thing and sort out the mess. Yet if that is to happen there must be an open debate before the election. What will Labour's "tough choices" mean in practice? David Cameron, the Tory leader, said on September 8th that he would cut ministerial salaries and reduce the cost of Parliament, but these pledges are no more than a gesture. Where precisely will the Conservatives make big economies in public spending?

Mr Darling has an opportunity to fill in the blank spaces later this year in his pre-budget report. If he grasps it, that will put pressure on the Tories to come clean about just how they would reduce spending. The more candour the better. In a report on the British economy in July, the IMF said, in strangled

euphemisms, “Building a broad public consensus on the need for sizeable fiscal adjustment will be essential in meeting fiscal challenges.” Translation: public buy-in is vital if the painful cuts needed after the election are to be carried out.

The growth of home tutoring

Top-up teaching

Sep 10th 2009
From The Economist print edition

The booming business of providing extra education out of school

AFTER three years in school, seven-year-old Dan could barely scrawl his name. Yet another parent-teacher meeting had come and gone at which his mother, Jackie, rehearsed her concerns and Dan's teacher pooh-poohed them. Then Jackie saw a retired teacher's advertisement in a local shop, offering help with reading and writing. After just three weeks of one-to-one tuition for an hour every Saturday morning, she saw a big improvement in her child—and since she could not bring herself to tell Dan's school that she was paying to remedy its deficiencies, his teacher assumed her marvellous teaching was responsible.

No one knows how many people work as home tutors: the business is unregulated and many work for cash in hand. But more youngsters are getting education on the side than before. A recent survey by the Sutton Trust, an education charity, found that 22% of parents with 11-16-year-olds in state schools had paid for tutoring at some point. Four years ago, 18% had.

Tutoring also starts earlier now than it used to. The standardised tests pupils take at age seven mean that parents whose children are falling behind find out earlier than previously—and today's cash-rich, time-poor working mothers may well decide their only option is to pay for the homework help their own mothers would have seen as part of their job description.

Even parents who already pay for schooling no longer seem to think that tutoring is unnecessary: Charles Bonas, the managing director of a London-based tutoring agency, Bonas MacFarlane, says most of its clients are privately educated. In response to rising demand, the annual "Good Schools Guide", the bible for middle-class parents choosing their children's next academic step, recently added a chapter on finding a good tutor to its usual analyses of state and private schools.

Underlying this demand is increasing competition to get into the most prestigious universities. Even in the era of university top-up fees it is the taxpayer, not the student, who pays most of the cost of a degree. To limit its liability the government caps student numbers. But school-leaving cohorts have been getting bigger for some years now, and a larger share of school-leavers are going on to further study. The battle for places is particularly acute this autumn because of the shortage of entry-level jobs (see article).

Counter-intuitively, perhaps, rampant grade inflation is adding to the competitive pressure. Students cannot rest on their laurels in the firm expectation of a sheaf of A-grades but take even more care to get them. An eighth of all those taking A-levels now get at least three As. So universities also look at GCSE results when deciding whom to admit—and approach admissions as an exercise in finding reasons to say no. A youngster who slacks or slips up will quickly find that there is no way to redeem himself. So many parents, including those paying for private schools, see home tutoring as a near-compulsory insurance policy.

One side-effect is a generation of young people who think that making sure they learn is someone else's job entirely. "Lazy rich kids who had been mucking around, and coming up to exam time realised they needed help", is how one tutor describes his pupils. "A lot of it is just checking to see they are doing what they've been assigned," says another. She describes the role of a tutor as "somewhere between hand-holding and prison-guarding".

Another, equally undesirable, is that the league tables of exam results that are used to compare schools are worth a good deal less than meets the eye. A good showing proves little more than that a school is patronised by parents who will do whatever it takes to get good results for their children, not that it does much in the way of quality teaching itself.

Teaching assistants

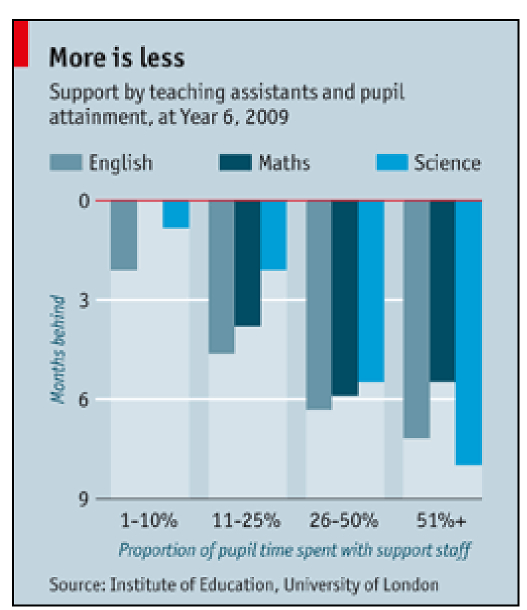
Unintended consequences

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The more help children get, the worse they seem to do

TRADITIONALLY, Britain has been an educational skinflint. For years its spending lagged behind the rich-world average. Under Labour all that changed. Teachers were awarded big pay rises, lots of money was spent renovating dilapidated schools—and an army of teaching assistants were hired to help keep order in the classroom and relieve teachers of routine paperwork. The number of these classroom helpers, who often have few or no educational qualifications, has exploded, from 60,600 in 1997 to 176,000 today. Proud government ministers frequently refer to the increase.

But that pride has been tarnished by the results of a study* commissioned by the Department for Children, Schools and Families, which suggests that support staff may be holding children back. The researchers collected data on children between the ages of five and 16. At every age and in most subjects, children who got help from teaching assistants or support staff did worse than those left to their own devices. Damningly, in many combinations of age and subject, the more help children got, the less well they did. Pupils in the final year of primary school who received the most support in science, for instance, were roughly eight months behind their unsupported peers (see chart).



Because the finding was unexpected, the researchers are unable to say exactly why teaching assistants seemed to be keeping their charges back rather than advancing them. Obvious confounding factors are controlled for: it is not that dimmer pupils were assigned more help, for example. One suggestion is that teachers use assistants as convenient minders for the most difficult pupils, precisely the ones who, in theory, should be getting the most "face time" with teachers themselves. Most teaching assistants are untrained (many are mothers, attracted by the convenient working hours), and the researchers note that they tend not to be involved in planning lessons.

Not all the news is bad, however. Teachers were mostly enthusiastic about the impact of their underlings, saying that teaching assistants did indeed help them to improve classroom discipline, freed them from tedious administrative tasks and brought the occasional specialist skill into the classroom (computer savvy, for instance, or advice on careers). Nice benefits to have, but a system that makes things worse for the poorest-performing children is surely doing exactly the opposite of what it should.

* http://www.dcsf.gov.uk/research/data/uploadfiles/DCSF-RR148.pdf

Televised election debates

Ready for his close-up?

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From The Economist print edition

The prime minister is dragging his feet

Corbis



EVERY good student of politics knows what happened in the American presidential race of 1960. An experienced and formidable vice-president, Richard Nixon, was expected to defeat the young Democratic contender, John F. Kennedy. That is, until their televised debate, in which JFK looked calm and sweetly reasonable, Nixon sweaty and shifty. People who listened to the debate on the radio scored it for Nixon; but television viewers went for Kennedy, and he won the election.

Gordon Brown is an excellent student of politics (the American kind in particular); and that precedent may partly explain why he has hesitated to agree to the sort of trial by television that Tricky Dick flunked. Yet Britain looks increasingly likely to hold its first televised debates among prime ministerial candidates during the general-election campaign due to start shortly. Sky News has said that it will stage one with or without Mr Brown. If he fails to turn up, he risks being represented by an empty chair.

The idea has been mooted before. William Hague, then leader of the Conservative Party, was keen to debate Tony Blair in 2001. The prime minister refused. Despite Mr Hague's quick wit, Mr Blair might have come off well; but since he was heading for a landslide victory anyway, he saw no reason to take the risk. The situation now is, in a way, the reverse: David Cameron, the current Tory leader and odds-on favourite to win the next election, has agreed to the debate, as has Nick Clegg, leader of the Liberal Democrats. Only Mr Brown, perhaps concerned about his younger opponents' telegenic advantage, has sounded sceptical (though his position has now softened into something like "we'll talk about it later").

It is amazing that, in 2009, Britain is still debating debates. They are rarely quite so transformative as the Nixon/Kennedy clash. But a live showdown might help to excite a worryingly apathetic electorate. And the arguments trotted out against debates are weak. One is that Britons technically vote not for party leaders but for individual MPs (though lots of people can't name their representative). Another is that the main contestants already face each other every week in Parliament at prime minister's questions (which is usually rowdy and infantile).

Mr Brown's stance is part of a broader reticence to engage with the public that helps to explain why his ratings have sunk so low. His experiments with new media, such as a famously absurd appearance on YouTube, have not always been successful. Yet taking on Mr Cameron and Mr Clegg might soften his aloof image. So as well as being good for the country, the debate, if and perhaps when it happens, might even be moderately good for Mr Brown.

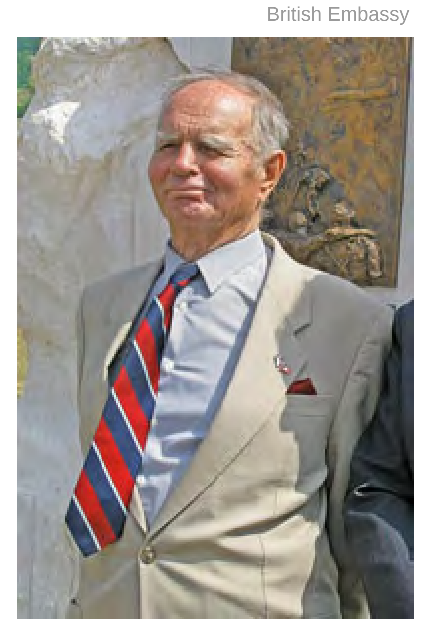
Britain and Montenegro

An Anglo-Balkan moment

Sep 10th 2009 | BREZNA
From The Economist print edition

Wartime derring-do on a bleak black mountain

British Embassy



Lawson, back in town

NOTHING of global importance has happened in the straggling mountain village of Brezna, in northern Montenegro, except once. On a single day in August 1944, this neglected and scruffy place won a place in the annals of world conflict. It was the centre of a great moment of synergy between Britain and Yugoslavia's communist-led partisans.

Imagine the scene: wave after wave of Dakota aircraft swooping through a canyon to land at an improvised airstrip, fashioned from a stony field only days earlier by local women, children and old folk. With Nazi forces advancing rapidly on the valley and British Spitfires desperately trying to draw German fire, the transport planes evacuated about 1,000 wounded partisans in a matter of hours. Each aircraft took 25 minutes to load, and carried some 35 passengers. The whole thing required seamless co-ordination between Britain (or, more precisely, the multinational "Balkan Air Force" which British officers had formed a couple of months earlier) and the resistance forces under the command of Josip Broz Tito.

This month a group of British diplomats and military officers went back to Brezna to commemorate the event along with their new friends in the government of Montenegro, which has been an independent country since 2006. Philip Lawson, a Suffolk farmer now in his late eighties, returned to the place where, as a young flight lieutenant on a secret mission, he had spied out a potential airstrip and encouraged the local people to scythe the fields and remove the rocks. "Just doing my job," he recalled, as grizzled partisans of a similar vintage warmly embraced him.

And in a display of contemporary co-ordination, there were parachute drops, aerial aerobatics and folk dancing. A monument to the landings, hewn out of local rock, was unveiled by Boro Vucinic, Montenegro's defence minister. It was, some said, the least he could do: the recent creation of a civilian-led defence ministry (a new concept for post-communist states) was also thanks to some quiet British help.

Yet some recall the Brezna landings less fondly. Survivors of the rival resistance movement, the royalist Chetniks, still seethe over Churchill's preference for the more effective communist partisans. (A pragmatic choice, the Brits said, though royalists blamed a secret Kremlin hand in British policy.) And the roughly one-third of Montenegrins who mourn the demise of Yugoslavia mainly remember Britain's role in bombing them during the Kosovo war in 1999.

This ceremonial remembrance of heroic derring-do more than half a century old says something about Britain's search for Balkan allies today but perhaps more about Britain's view of itself as a fighting nation. If there is one thing at which its diplomats and soldiers instinctively excel, it is celebrating its own great military feats. They know what to remember and what to airbrush out.

Bagehot

The end of the age of war

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Britain's contradictory attitude to warfare—and shifting view of Afghanistan

Illustration by Steve O'Brien



“MINE is the first generation able to contemplate the possibility that we may live our entire lives without going to war or sending our children to war.” So said Tony Blair, then a novice prime minister, in 1997. It didn’t turn out quite that way.

Mr Blair and Gordon Brown have presided over more than a decade of almost continuous war. First came the 1998 air strikes on Iraq; then Kosovo, Sierra Leone, Afghanistan and Iraq proper (and, since 2006, a much bigger Afghan commitment). British forces have fought in the jungle, fought in the desert, fought in the Hindu Kush and dropped many bombs from the air. Unforeseen events and emergencies have contributed to the frenetic activity; so have Mr Blair’s doctrine of liberal interventionism and his creeping messianism, plus an atavistic Labour fear of seeming “soft” on defence and the perceived need to stand by America.

Foreign war has become a fact of British life. The question is now where, not whether, British troops are waging it. The weekly tributes to the fallen at prime minister’s questions are a ritual as familiar as the speaker’s cry of “order, order”. Yet suddenly, as other orthodoxies are debunked and the government itself faces ejection, the consensus for war seems to be breaking too.

The long withdrawing roar

In Britain, Afghanistan has generally been regarded as the “good war”. The invasion of Iraq was sullied by manipulated intelligence, bad planning, human-rights abuses and, for Britain, the hurtful idea that its army underperformed in Basra. In contrast, the Afghan mission seemed unarguably virtuous. This moral confidence, and the lower rates of casualties (until two years ago), help to explain why, for a long time, Afghanistan was overshadowed by Iraq in British debate. But there are now very few British servicemen in Iraq, against 9,000 in Afghanistan. Attention has switched—and the “good war” is looking more complicated.

It is partly the summer spike in British fatalities (to well over 200 in total since 2001), their faces and tragically young ages instantly relayed across the country. It is partly that the deployment has lasted so long, and the fighting in Helmand province has been so much bloodier than was once expected. Meanwhile the war's aims have become blurred—and few seem to have been achieved. The purpose emphasised by the government—the need to protect Britain from terrorism—looks questionable. Some of the most powerful arguments for staying the course, such as the consequences of quitting for relations with America, and for the morale of both the British army and Islamist terrorists, are not made much in public. At the same time the economic climate has raised doubts over the wisdom of retaining such grandiose military ambitions. Afghanistan has for many come to seem a flawed war of choice rather than of necessity.

Mr Brown's own demeanour has contributed to the mood. Try as he may, as in a speech on Afghanistan last week, he can't help conveying a sense that war is a distraction he has reluctantly inherited. Foolish rows over wounded veterans and the rights of Nepalese Gurkhas, and spats between ministers and senior officers, have fed that impression. But the air of unease and retrenchment is broader than prime ministerial semiotics (it increasingly pervades newspaper coverage of Afghanistan too) and deeper. Just as current views about what to do with British troops are confused and divided—between a wish to bring them home, and calls to dispatch more of them to Helmand—Britain's overall attitude to war is oscillating and contradictory.

For it isn't just the past ten years. A British soldier has died on active duty in virtually every year since 1945. As well as actual insurgencies, the empire bequeathed a yearning for greatness and a willingness to pay for it in blood. The Falklands conflict of 1982 and the struggle with Republican paramilitaries in Northern Ireland enjoyed overwhelming support. It is an item of faith among Britons that their armed forces—like their health service and assorted other household gods—are "the best in the world".

Yet, oddly, the engagements that are best commemorated in British lore involve relief and rescue, or noble endurance, rather than triumph. Memory of the second world war, for Britain the template of martial heroism (Churchill is the eternal standard of leadership, Hitler the paradigm for enemies), is dominated by the retreat from Dunkirk and London's defiance during the Blitz. Britain's favourite war poem eulogises a cavalry brigade that charged in the wrong direction. Noticing this quirk, Orwell remarked on "the English hatred of war and militarism". The popular view of war, he wrote, "is invariably defensive".

This strange mix of belligerence and prickly defensiveness is a common characteristic of imperial nations. In Britain's case the tension probably has something to do with geography. The Channel mostly saved it from the invasions and savagery that have blighted continental Europe, much of which is more sceptical and reticent about conflict; but on the other hand Britain has been more directly affected by Europe's turmoil than America, and more traumatised, especially by the slaughter of the first world war. The protective instinct that the trauma encouraged seems now to be resurfacing.

This subtle shift has not yet reached the level of high politics. Nick Clegg, the leader of the Liberal Democrats, has bravely voiced worries about the strategy, resources and prospects of the Afghan campaign that others discuss only in private. The Tories have grumbled about the blatantly rigged Afghan election. For fear of seeming unpatriotic, no prominent politician is calling for withdrawal—yet. Nevertheless, the momentum of the war and opinion about it seem to be heading that way. As Mr Blair learned, making predictions in such a volatile world can be hazardous. But the end of Britain's era of war may be approaching.

Economist.com/blogs/bagehot

UNESCO and World Heritage Sites

The limits of soft cultural power

Sep 10th 2009
From The Economist print edition

Guarding precious and vulnerable places is one of the better things the UN's cultural agency does—but it may topple over if it stretches too far

Alamy



ANYONE who dreams of exercising authority (of a fairly benign sort) over the entire world—with a special remit for the planet's most beautiful and fragile places—will enjoy perusing the 250 or so pages that contain the latest pronouncements from UNESCO's World Heritage Committee.

Swooping elegantly from the valleys of the Andes to the walled cities of Europe, from misty Chinese mountains (like Emei, pictured above) to lawless African game parks, the document doles out scoldings, warnings and praise to politicians, curators, animal conservationists and mayors. Some are congratulated for following the UN cultural agency's advice; others are given dark hints of what will happen if sites do not receive proper care.

This year's most dramatic move was a rare decision to strip a place—Dresden and the surrounding Elbe valley—of its status as a "World Heritage Site": that is, a location deemed to be of universal worth to humanity by virtue of its built environment, ecological importance or both.

The German metropolis, belatedly restored to its Baroque glory after massive wartime bombing, was punished because of a motorway bridge that threatens to wreck the skyline. (The only other place to have been delisted is an antelope sanctuary in Oman, where the government actually wanted to renounce the status.) Meanwhile UNESCO accepted 13 new sites, including a sacred peak in Kyrgyzstan and a fortress in Burkina Faso, bringing to 890 the number of places under its purview.

What makes this whole procedure tolerable (and indeed, respected) is that it is a voluntary arrangement between governments, with groups of states taking turns to form committees that duly exercise UNESCO's moral power. At least in theory, it is not the permanent staff of the World Heritage Centre (a smallish part of the UNESCO bureaucracy) who exercise dominion over the glories of the earth, but the 186 states that have ratified the World Heritage Convention and thus signed up to the notion that some places are too precious to be left at the mercy of one government alone.

The powers of persuasion

How well does the system work? Francesco Bandarin, the Italian who runs the World Heritage Centre, points to a string of successes—cases where UNESCO has become a voice in a country's internal debates and exercised a healthy influence in favour of conservation.

An architect with a fondness for old cities that are evolving, Mr Bandarin relishes the memory of his sparring matches with Ken Livingstone, then mayor of London, whose love for skyscrapers cast a shadow over the Tower of London and the Palace of Westminster, both of which are UNESCO sites. "He wanted to build Shanghai in London," the Italian says of the maverick socialist mayor. What UNESCO should be protecting, he says, is not stones but human values; cities must develop in ways that cater to present needs but also respect and integrate the past.

The UNESCO practice of naming and shaming works well in countries with vigorous domestic disputes—like Ireland. Having been forced by UNESCO to defend their stewardship of a monastic island, Skellig Michael (see article), the authorities in Dublin are now keen to prepare more sites for UNESCO approval and raise their hitherto weak profile in the agency.

The soft power of UNESCO can also work in authoritarian states (including post-Soviet ones, like Azerbaijan) where internal discussion is muted but international opprobrium is unwelcome.

But the process breaks down in countries where governance hardly exists. One of UNESCO's big disappointments, Mr Bandarin says, was the ineffectiveness of its efforts—along with several other agencies—to preserve a rare white rhinoceros at Garamba national park in Congo. At one point, UNESCO and its partners were paying wardens in banknotes flown from Kenya; but that system broke down.

Places where tourism and other economic activities are expanding uncontrollably may also trample on UNESCO's high principles, which seek to preserve the integrity of sites and their surroundings. In China a UNESCO endorsement translates quickly into tourist revenue—and all manner of strange tourist-pleasing activities.

On the Emei mountain, for example, visitors now see not only a famous Buddha statue, but a series of man-made caves with copies of other Chinese Buddhas—and nearby there is a brand-new statue of Shiva, an unrelated Hindu deity. "You have to peer at the plaque closely to see whether the object in front of you is Han dynasty or 21st century," in the wistful words of one recent visitor.

Short of an outright delisting, UNESCO can put sites on a "danger list". Sometimes this is done in co-operation with a government (as happened this year with Colombia's Los Katios park, threatened with deforestation); and sometimes such a listing is a way of admonishing a government. For example, Georgia was told this year that it is not taking proper care of the ancient ecclesiastical centre of Mtskheta.

UNESCO likes to boast of the mind-concentrating effect of the mere suggestion of delisting. Under pressure from the agency, the Greek authorities were dissuaded from building an aluminium plant near the site of the Delphic oracle and Egypt held off from building a highway near the Pyramids of Giza.

But as the number of sites nears 900, will not the currency of UNESCO's praise and scoldings be devalued? It is embarrassing for Dresden to be the only place delisted against its will; but if half a dozen cities decided to ignore UNESCO's ire and proceed with their own development plans, that could make the agency look foolish and toothless.

At a minimum, UNESCO's best hope of preserving its moral authority must surely lie in much deeper co-operation with independent agencies and private donors. Mr Bandarin says the agency is happy to pool its efforts with NGOs and private foundations. The only initiative in the field that he does not welcome is a competition which a Swiss-based foundation launched to choose the "seven new wonders of the world" by electronic ballot. This seemed to be benefiting from UNESCO's work, while doing little for the cause of conservation.

Embarrassingly, one of UNESCO's closest partners—the Geneva-based International Union for the Conservation of Nature—issued a report this year suggesting that the UN agency was too hesitant to declare sites in peril, and too sensitive to the feelings of member states. Putting it more bluntly, Jeff Morgan, director of the California-based Global Heritage Fund, says UNESCO presents too rosy a picture of the world when it implies that only a handful of significant sites are at risk. "UNESCO's cause is noble, but they have done too little to raise awareness of the destruction going on," Mr Morgan says. "The reality is that few sites in the developing world comply with all UNESCO's rules."

He also thinks UNESCO has been too cautious about co-operating with private business, although the UN agency has a modest partnership with Expedia, an online travel firm. Lobby groups with a narrower remit—to protect animals or conserve architecture, for example—have raised hundreds of millions of dollars in corporate sponsorship. UNESCO may fail to save the world's patrimony unless it swallows its scruples and does likewise.



UNESCO's leadership

A race or a death-wish?

Sep 10th 2009
From The Economist print edition

An unlikely candidate adds to questions about an agency's will to live

IF AN American talk-radio host wanted to cook up some tale that would blacken the name of the United Nations for ever, he could hardly have come up with anything spicier. At least until this week, the prime candidate for the leadership of a UN agency that is supposed to promote "education, science and culture" is an Egyptian who (in an outburst he now says he regrets) once threatened personally to burn any Israeli books found in his country's libraries.

AFP



Stick to painting, some tell Hosni

Bizarrely, it seems that Israel agreed not to oppose the elevation of Farouk Hosni (his country's culture minister for the past two decades) as part of a broader diplomatic trade-off with Egypt. A painter who commands high prices and occupies a lavish, gaudy residence on the banks of the Nile, the candidate is close to Egypt's first lady, Suzanne Mubarak. So Western countries who value Egypt's friendship may also find it awkward to mount an open campaign against this unappealing aspirant, who is grudgingly respected by Egyptian secularists for keeping fundamentalism at bay.

But in the informal soundings that are now going on at UNESCO's Paris headquarters, there are other names who look better placed to pursue UNESCO's saner goals, like promoting girls' education. One is Benita Ferrero-Waldner of Austria, a European Union commissioner. Though seen as a lightweight in Brussels, she would be a decent steward of UNESCO—assuming it wants to exist at all. One of the agency's latest productions—an explicit sex-education manual to be used from the age of five—bore the hallmarks of an outfit trying to end its own life.




Iran, North Korea and the bomb

Spinning dark new tales

Sep 10th 2009
From The Economist print edition

Something new to worry about

HONESTY is a rare commodity in the nuclear underworld, where Pakistan, North Korea, Iran, Syria and possibly others—as well as Argentina, Brazil, Libya and South Africa in times past—have long done deals for the equipment, technology and materials needed for their illicit nuclear programmes. Yet North Korea and Pakistan's notorious blackmarket-maker, Abdul Qadeer Khan, have both proudly and separately decided to tell the world more about their nuclear exploits. By contrast there is a worrying silence from Iran and Syria, two countries in the spotlight this week at the International Atomic Energy Agency, the UN's nuclear guardian, for their suspect nuclear activities.

Iran's refusal to answer inspectors' questions about mounting evidence of nuclear-weapons-related work, or to pick up the offer of talks on its nuclear ambitions from America, China, Russia and three European states, bodes ill for the diplomatic effort to hold the non-proliferation line. Come the UN General Assembly later this month, foreign ministers of the six will be taking stock of Iran's readiness to co-operate before they decide whether to start the hard job of trying to agree more sanctions. They will have little to go on.

Pressed by Russia and China, which have dragged their feet over further sanctions, to show the minimum of willing, Iran handed over its counter-offer on September 9th. The one thing off the agenda, says Iran's president, Mahmoud Ahmadinejad, is what everyone else wants at the top of it: a suspension of Iran's nuclear work, especially its uranium enrichment and any plutonium-related efforts, until Iran can re-establish confidence (of which there is anyway precious little by now) that its nuclear programme is, as it claims, peaceful. At this rate, in a few months the whole diplomatic effort will have run into the Persian sand.

Meanwhile, Iran's protestations of innocence have been undercut by Mr Khan's explanation last month to "Islamabad Tonight", a television talk show in Pakistan, of how in the 1980s Iran secretly sought his help with nuclear technology. "We" wished Iran to acquire such technology, he said, implying official backing for the deals eventually done through his network. "Iran's nuclear capability [would] neutralise Israel's power," he added.

Similar job-lots of centrifuge equipment for enriching uranium, potentially fissile material for a bomb, delivered by Mr Khan and his associates to Libya had come with the design of a nuclear warhead thrown in. Caught out in 2003, Libya handed over both the design and information that helped expose the Khan network. Had Mr Khan sweetened the deals with Iran and North Korea in the same sort of way? Nobody knows. Arrests of his associates in Switzerland turned up digitised versions of an even more sophisticated warhead than that passed to Libya.

North Korea is now boasting that it has completed experiments to enrich uranium, giving it potentially a second stream of fissile material (it has already tested two plutonium-based bombs). That is discouraging, but hardly a surprise. In 2002 North Korean officials privately admitted to the Americans what they were up to (before later denying it again publicly). But no one knew how far they had got.

Mr Khan would neither confirm nor deny—"maybe" was all he was prepared to say, and "at the moment"—that he had supplied North Korea with such equipment. He implied that whatever he had done anyway had state backing. But General Pervez Musharraf, Pakistan's former president, had already revealed that in the 1990s Mr Khan had supplied North Korea with some 20 of the necessary centrifuge machines, with instructions on running them.

Either way, even with Mr Khan out of the picture and some of his network rolled up, there is scope for mutual help between his customers. North Korea is known to have secretly built a nuclear reactor for Syria, of the sort it used to make the plutonium for its own bomb; that structure was destroyed in an Israeli air raid in 2007.

North Korea's claim (assuming it is true) that it can now enrich uranium opens up a another dark possibility. Centrifuge machines are hard to operate. North Korea will have needed help in getting them up and running. North Korea and Iran are already known to co-operate intensively in developing nuclear-capable missiles. So what is to stop them helping each other with their nuclear programmes? North Korea has plutonium and warhead-building skills. A master tunneller, it could also help any country wanting to hide its nuclear efforts from satellites. Iran, meanwhile, has the uranium-enrichment skills that North Korea previously lacked. Small wonder Iran thinks it can enrich on happily.

Higher education and the recession

It still pays to study

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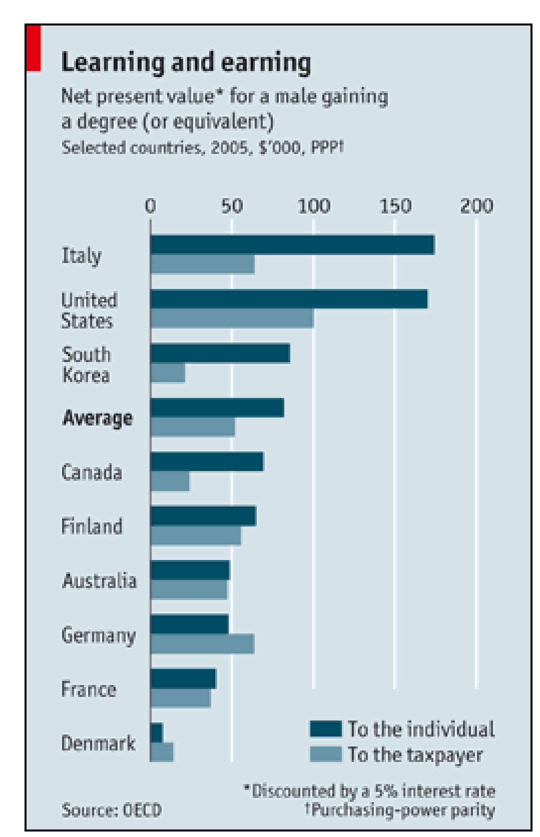
Not the panacea it is billed as, but the best hope for this year's school-leavers

THE law of supply and demand tells you that increasing the quantity of something tends to reduce its price. But not, it seems, in higher education. That is the puzzle on display in "Education at a Glance", the annual research compendium published by the Organisation for Economic Co-operation and Development (OECD), a Paris-based think-tank for the industrialised world. "Every year we wonder if this will be the year that higher education starts to lose its value—and every year, there is no sign of it happening," says Andreas Schleicher, the OECD's chief of education research.

The newly published edition shows ever more rich-world school-leavers gaining higher qualifications: only a fifth in 1995 and almost twice that in 2007, the latest year the OECD has studied. Mr Schleicher says that there are already more graduates than he thought were needed only five years ago. Yet despite the vastly greater supply, employers still reward them well for the time and money they invest.

"Education at a Glance" is a good guide for governments wanting to copy other countries' homework. The recession gives its findings new urgency. Since much of the cost of higher education is forgone earnings, its advantages are even clearer at a time when jobs are scarce.

The OECD's answer is simple: the more education, the better. Taking into account tuition fees, lost earnings while studying and extra taxes paid, a male graduate is still $82,000 better off (see chart) in net present value terms than one whose education ended with the equivalent of a high-school diploma. (Women graduates benefit, but by less, since they work and earn less.) Figures show that, so far, the taxpayer has gained too, by more than $50,000 per graduate, even after subtracting the public funds that helped to pay for their studies.



Potential students are applying for university in record numbers. But supply has failed to grow in step. Cash-strapped American states are slashing public universities' budgets. Private colleges' endowments' have shrivelled. That means cutting posts, salaries and aid to students.

In Britain taxpayers still pay much of the cost of undergraduate education. So universities are forbidden to "over-recruit". This autumn they turned away 40,000 applicants whose grades would normally have got them into university. And in pretty much every country where taxpayers pay for higher education, new students will find teaching is skimpier.

A country can still waste its graduates, notes Mr Schleicher. He cites Spain, where the returns to a degree have fallen significantly in recent years. "The labour market did not adapt to utilise these new skilled workers," he says. But some doubt the intrinsic connection between higher education and growth. Alison Wolf of King's College London, the author of a book provocatively entitled "Does Education Matter?" says a big reason why school-leavers go to university is peer pressure. With many graduates to choose from, employers increasing turn up their noses at anyone who does not sport a degree, no matter what the job's requirements. The result is more akin to an arms race, with everyone running to stand still, than a recipe for increasing prosperity.

A degree signals prior ability as well as the skills that have been learnt, she notes; and returns to education depend partly on a country's labour-market structures.

“Danish degrees look less valuable than American ones, but Denmark is one of the world’s most successful economies. Are Danish graduates really less skilled than American ones? Or is it that Danes tolerate lower pay differentials and higher taxes?”

For would-be students now, such debates are, literally, academic. When the jobs market finally picks up, many will be poorly placed. The young unemployed all too easily become the long-term unemployable. Make-work schemes mop up some of the jobless, but may blot a curriculum vitae. Time at university, however ill-spent, does not. So it may be worth rethinking the wisdom of ever-expanding higher education. But not this year.

A golden chance

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Just a decade ago Indonesia was on the brink of catastrophe. Things have taken a dramatic turn for the better, says Simon Long (interviewed here)

Getty Images



COUNTRIES generally hit the headlines only when the news is bad. In Indonesia it has often been spectacularly bad. A decade ago there were fears that the country might disintegrate in a welter of violence, piracy and mass migration. Its former dictator, Suharto, set new standards for kleptocracy. As he fell in 1998, the economy collapsed. The Bali bombing of 2002 that killed more than 200 people was one of a series of such attacks, and the lingering danger of Islamic terrorism was recalled by another murderous blast in Jakarta in July this year. The country is prone to natural disasters too, from the tsunami that devastated parts of Sumatra in 2004 to this month's deadly earthquake in Java.

So Indonesia has an image problem. Foreigners may not realise, its boosters defensively suggest, that the world's third-largest democracy and fourth most populous country, with more Muslims than any other, is actually doing rather well. It enjoys political stability under a popular incumbent president, Susilo Bambang Yudhoyono (pictured above). The bombing in Jakarta was the first such atrocity for nearly four years. Economic growth has slowed, but the country has withstood the global slump well. Of big countries, only China and India are growing faster.

It still has enormous problems. Separatist tensions have eased, but it remains prone to sectarian and ethnic violence. Mr Yudhoyono has not met his promise in 2004 of halving the number of people living below the government's poverty line. More than 15% of Indonesia's 240m people are poor. Unemployment is high, at about 8%, and the workforce is growing faster than in any other country apart from India and China. Inequality has actually widened a little. Those who looted the country under Suharto, and the soldiers who connived at terrible abuses, have enjoyed almost total impunity. Indonesia is still one of the world's most corrupt countries. Its infrastructure is in woeful shape. And as another El Niño weather pattern takes hold, choking smog caused by forest fires is already smothering parts of Sumatra, drawing attention to Indonesia's role as the world's third-largest emitter of carbon.

Causes for hope

There are, however, four big reasons for optimism. The first is demographic. Over the next few years, thanks to a combination of a young population and a falling birth rate, Indonesia will see a surge in the ratio of its working population to the number of dependants. Next year, for the first time, more than half the population is likely to be living in urban areas, implying a further boost to consumption, the country's main source of economic growth.



Second, fiscal restraint in recent years has left the government with the resources to spend more on Indonesia's deficient infrastructure and public services. Having withstood the slump of the past year remarkably well, Indonesia is well placed to maintain solid growth rates for years to come. Considered a basket-case not so long ago, it is now seen as an extra "I" in the BRIC group of big, fast-growing emerging markets (Brazil, Russia, India and China).

Third, Mr Yudhoyono's re-election in July gives him a mandate for the reforms Indonesia needs. His victory probably owed much to his reputation as a doughty warrior against corruption, and to his policy of giving cash handouts to the poor. In the election campaign he and his running-mate, Boediono, a well-respected former central-bank governor, were attacked as "neo-liberals" by opponents playing the card of anti-foreign economic nationalism, but many voters simply seem to have shrugged this off.

And that leads to the fourth reason for optimism. Despite serious flaws in the electoral system and in the mishmash of parliamentary and presidential constitutions Indonesia has designed for itself, it seems likely to enjoy a period of political stability. Democratisation has been a mess, and much needs fixing. But Mr Yudhoyono now has the breathing-space to try.

More of the same, please

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A ringing endorsement from the voters

EPA



Megawati and Prabowo enjoy their fruitless moment in court

ANY young democracy must clear two big hurdles. It must undergo a peaceful transition from a leader to an opponent, and it must see an incumbent win an election without credible cries of foul. Indonesia has now crossed both barriers. In its first direct presidential election in 2004, the incumbent, Megawati Sukarnoputri, lost to Mr Yudhoyono. Miss Megawati, daughter of Indonesia's founding hero and leader of a tame opposition under Suharto, went into a sulk and boycotted Mr Yudhoyono's swearing-in. But power was handed over smoothly enough.

On July 8th this year Mr Yudhoyono won re-election in a landslide. This time both Miss Megawati, his main rival, and the also-ran, Jusuf Kalla, mounted formal challenges to the result. But few seriously doubted that it reflected the popular will. Mr Yudhoyono won 61% of the vote, compared with 12% for Mr Kalla, who had been his vice-president, and 27% for Miss Megawati. This dispensed with the need for a second-round run-off.

Indonesia's electoral system is impenetrably complex. In April, for the election of members of the parliament in Jakarta, known as the DPR, 171m voters across more than 900 inhabited islands had 38 national parties to choose from. To run for president, a candidate needed nomination by parties commanding at least 20% of the DPR or 25% of the popular vote. Only Mr Yudhoyono's Democratic Party had the numbers to nominate its man without outside help (see table 1).

A clear message 1

Indonesia's parliamentary-election results
April 2009

Party	% of votes	Seats won
Democratic Party & Islamic-party allies	45.0	314
Golkar	14.5	107
Democratic Party of Struggle (PDI-P)	14.0	95
Gerindra	4.5	26
Hanura	3.8	18
Other	18.2	nil*
Total	100	560

Source: General Election Commission

*No seats awarded to parties winning less than 2.5% of the vote

Miss Megawati's Indonesian Democratic Party of Struggle, or PDI-P, went into league with Gerindra, a party led by Prabowo Subianto. Mr Prabowo was once married to Suharto's daughter, and as one of the former dictator's special-forces commanders is accused of human-rights abuses. Mr Kalla, of Golkar, Suharto's political vehicle, teamed up with another controversial former general, Wiranto.

There was much to admire in the presidential election. The campaign was largely peaceful and the press coverage was vibrant and fair. The three presidential platforms were clearly different. Mr Yudhoyono offered "more of the same": stability tempered with modest reform. Mr Kalla promised (or, to judge from the voters' reaction, threatened) faster reform. Miss

Megawati and, especially, Mr Prabowo cast themselves as nationalist populists, proposing to reschedule Indonesia's foreign debt to release money for the poor. Turnout, though low compared with the previous democratic elections, was high by international standards: about 70%.

The SBY effect

Moreover, in the eyes of most Indonesians as well as foreign observers, the best man won. Miss Megawati was not much of a president. Mr Kalla fought a sharp and good-humoured campaign, but he could not quite shake off his image as a Suharto-era business crony dabbling in politics.

By contrast, Mr Yudhoyono, widely known as "SBY", seems both competent and hugely popular. Sound economic management has left Indonesia in a strong position to withstand the global downturn. His policy of giving direct cash handouts to the poor made economic as well as electoral sense. Separatist and sectarian conflicts in Aceh, Ambon and Sulawesi have abated. Terrorist attacks, until July's bombing in Jakarta, had been rare.

To foreigners, Mr Yudhoyono can seem rather aloof and ponderous, but many Indonesians see a decent man with a presidential manner. His critics charge him with being a ditherer, but his supporters say he will now prove them wrong. In his first term the Democratic Party needed the support in the DPR of Golkar and some smaller parties. Now the Democrats have become the biggest party, and their coalition partners—four small Islamic parties—will have less chance of holding the government to ransom. Mr Yudhoyono's position will be even stronger if Golkar, never comfortable in opposition, also decides to rejoin the government. He has promised to include more technocrats in his cabinet. His choice of running-mate, Boediono, was an earnest of his intentions.

Mr Yudhoyono, too, was a general under Suharto. But unlike Mr Prabowo and Mr Wiranto, he emerged without being credibly accused of complicity in extra-judicial killings or torture. Indeed, most criticism of his time in the army echoes that of his first term as president: that he was too indecisive. According to one possibly apocryphal story, the soldiers under his command in East Timor lost patience as they waited for his orders to attack a rebel-held hill, and took it without him.

Under Mr Yudhoyono's presidency the army shows little sign of such insubordination. Remarkably, only a short time after the end of a military dictatorship, a coup seems rather unlikely. Such judgments can be wrong: much the same was said, and soon disproved, of Thailand in the late 1990s. The Indonesian army played an even more pivotal role than the Thai one. Under Suharto it had *dwifungsi*, the "dual function" of helping to run the country as well as defending it. Now serving soldiers are barred from political office; indeed, the 410,000 members of the armed forces do not even have votes.

The defence minister, Juwono Sudarsono, an academic whom Mr Yudhoyono befriended in the early 1990s, argues that since Indonesia at the time of "reformation" in 1998 lacked a civic tradition, the only institution with "overarching reach and capacity" was the army, the "fulcrum of political life". But the army's relative lack of clout has been reflected in a budget that Mr Juwono describes as covering just 30% of what is needed, though it is now being beefed up.

Nor can the army any longer supplement its official budget so lucratively with the income from myriad businesses. It has gradually divested itself of its prominent role in much of the economy—from plantations to supermarkets, from office blocks to airlines. Mr Juwono says that of more than 1,500 army enterprises, only five "viable" businesses are left, and these will be disposed of by October, leaving only a few "low-level" co-operatives. But the army remains accused of informal, corrupt links with business, demanding protection money or providing security services to companies for chunky fees.

The scaling-back of the army's role is just one of many surprising achievements of Indonesian democracy. But it remains hard to feel entirely comfortable about a system that, 11 years after what looked like a revolution against a corrupt autocracy, produced a presidential contest of three tickets headed by, respectively, the incumbent, his deputy and his predecessor, and each featuring one of Suharto's generals.

Most Indonesians seem content to shrug off any doubts about the process and to congratulate themselves that democracy seems to be working. But there are grounds for concern. Adam Przeworski, a political scientist, once defined democracy as a way to institutionalise uncertainty. In Indonesia, the complex election process might have been designed to endorse a foregone conclusion.

The biggest worry is the electoral system itself. Evolving electoral law has sought to reflect the country's diversity while keeping the number of parties to a manageable level, so parties have to win at least 2.5% of the national vote to take seats in the DPR. Votes for parties that fall below this threshold are redistributed among those that exceed it—a total of nine this year. So some candidates who won the popular vote in their constituencies are excluded from the DPR, and parties that between them garnered 18% of the national vote ended up with no representation at all, which may alienate some voters.

One party that did make the grade is Mr Prabowo's Gerindra, which spent a lot of money on perks to supporters and on advertising. Mr Prabowo's brother, Hashim Djojohadikusumo, made a fortune in oil in Central Asia and has ploughed some of it into politics at home. H. Zulkieflimansyah, of the Prosperous Justice Party, or PKS, the most successful of the Islamic parties, cites Gerindra's rise from nowhere as evidence of a depressing trend: "People will vote for those who give them money."

This sounds like sour grapes. Money does play a big part, and at the village level many voters are subject to blandishments or intimidation from the local headman, who may in turn have been promised rewards or threatened with sanctions by politicians in higher tiers of government. But many Indonesians will take whatever freebies are on offer and cast their secret ballot as they would have done anyway.

A more serious concern is the absence of a national, computerised register of voters. The list for the parliamentary elections produced by the independent election commission was flawed. Millions may well have been excluded, including many migrants in big cities such as Jakarta. But nobody has produced compelling evidence of a conspiracy as opposed to incompetence. It was, says one analyst, "equal-opportunity disfranchisement".

Registering a complaint

For the presidential poll the list was improved somewhat, and the Constitutional Court helped by ruling that unregistered voters could cast ballots if they produced their identity cards. What really saved the day, however, was the margin of Mr Yudhoyono's victory. According to Marcus Mietzner, an expert on Indonesia at the Australian National University, "with a tighter field of candidates the electoral system would collapse." He points to three closely fought regional elections in recent years—in North Maluku, South Sulawesi and East Java—that resulted in fiercely contested outcomes.

Indeed, it was the scandal this year over a governor's election in East Java, won by a candidate backed by the Democratic Party, that did most to raise doubts about the integrity of the system. More than a quarter of the names on the list were found to be duplicates or bogus. The police commander who unearthed the irregularities was shunted into early retirement, giving a strong impression of a cover-up.

The parties themselves lack any clear ideological or social base. Mr Mietzner contrasts this with Indonesia's failed experiment with democracy in the 1950s, when politics was dominated by three powerful forces with different visions: nationalists, Communists and Islamists. Now all the parties accept the basic contours of the Indonesian state. They differentiate themselves by their distinctive cultures and by the personalities and lineages of their leaders.

The Democratic Party, for example, in Mr Zulkieflimansyah's scathing but not wholly unfair analysis, is simply "an SBY fan-club". Formed in 2001 to back Mr Yudhoyono's presidential aspirations, it relies on his popularity for its success but still lacks a substantial grassroots organisation or clear policy programme. This explains why Mr Yudhoyono felt the need, soon after winning this year's election, to deny that his family had plans for his wife to succeed him when he reaches the end of his second and final term in 2014. Some members of his party had indeed hoped she might; others speculate that, with a parliamentary majority large enough to amend the constitution, he may in time face pressure to abolish term limits. Mr Yudhoyono claims his family has no political ambitions beyond 2014, but his failure to build up the party, or let another strong leader emerge from within it, opens the way to such speculation.

The opposition PDI-P's dynastic ambitions are clearer. Among Miss Megawati's likely successors are her daughter and her brother. Many of the smaller parties are also family concerns. Of the big three parties, only Golkar combines a grassroots organisation with some non-hereditary leadership competition. With its origins in the Suharto "new order" regime, Golkar seems a waning force, but its big-business backing and nationwide reach mean it is unlikely to fade away.

Defending the failure of the system to come up with new faces, Indonesians often argue that the Suharto years inhibited the development of a generation of political leaders. But 2014, they say, will be different,

as politicians emerge from the new DPR or from popular regional or local government. It is true that the DPR is full of new faces—two-thirds of members are newly elected and 60% are under 50—and that decentralisation has produced impressive local leaders, some of whom may aspire to the national stage. But few observers would rule out a presidential contest in 2014 fought out among the present incumbent's wife, the opposition leader's daughter, a Suharto-era general with a human-rights problem and a Golkar businessman recycled from the 1990s.

Free to air

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From dissident outcast to mainstream media

HAD things turned out differently, Santoso might have been in jail or in exile by now. In the late 1990s, as chairman of the Association of Indonesian Journalists, a union formed to fight the restrictions of the Suharto years, he spent time in hiding. Now he is managing director of a thriving radio station whose programmes are syndicated to 650 stations in Indonesia and to ten other countries. One of the greatest victories of the *reformasi* movement of 1998 has been the freedom of the press.

Of all the media, news radio may have suffered most under Suharto. There were over 700 private stations, but they were banned from producing their own news programmes and had to take bulletins produced by state radio. After Suharto fell, Mr Santoso and his colleagues saw an opportunity. In the vast archipelago, radio offers a cheap and effective way to disseminate news. Their station, KBR68H, opened in 1999 with a false start as it tried to distribute programmes over the internet. Partner stations had to spend hours downloading programmes. Satellite proved a better alternative.

KBR68H now has 120 staff, including 50 Jakarta-based journalists. Its local partners provide a nationwide network of reporters. It even has a workable business model, though partners pay only a tiny subscription of $15 a month for the programmes. One of many international awards it has won, the King Baudouin prize for international development, has produced enough money to finance a new studio. But most of the revenue comes from advertising. The election season proved lucrative. Now Mr Santoso is expanding, setting up a station for Jakarta concentrating on environmental issues and a brace of television programmes.

He has never had any trouble from government censors, though angry Islamic groups once took to the streets against the station. In recent years the Constitutional Court has struck out clauses that made it a crime to insult leading politicians, but defamation laws remain a constraint on the freedom of expression. Earlier this year there was outrage over the conviction of Prita Mulyasari, a woman who had complained on Facebook about her treatment at a hospital. The case was thrown out on appeal, but the prosecutors, in turn, have appealed.

Things do not fall apart

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Because the centre does not hold

Reuters



Aceh at peace

THE Suharto regime used to argue that if East Timor became independent, it would set off an archipelagic chain reaction. So when in 1999 East Timor voted for independence, Indonesian soldiers and their local allies responded with a furious burst of arson and violence. With this disaster coming so soon after the Indonesian economy collapsed, there were fears that Indonesia might unravel. To make matters worse, an ethnically, linguistically and culturally diverse archipelago was dominated by Java and the Javanese. It still is.

The response to the resentments and frictions left behind by the Suharto years included one of the most ambitious decentralisation programmes attempted anywhere. In the first stage of this, in 2001, the two provinces with the strongest claim to statehood—Papua (since divided into two provinces, Papua and West Papua) and Aceh—were granted enhanced autonomy.

Meanwhile resources and responsibilities were transferred from central government to subnational ones—primarily provinces and *kabupaten*, or districts—which became responsible for most public services. From 2005 direct elections were introduced both for provincial governors and heads of districts (*bupatis*) and municipalities (mayors), creating a new breed of accountable local officials with their own constituencies.

Indonesia's current integrity as a country is a tribute to these policies. Devolution may also have helped restore a degree of social harmony in places such as Poso (in Sulawesi) and Ambon (in Maluku) which had been riven by sectarian violence between Muslims and Christians.

One of the proudest achievements of the first Yudhoyono administration was the 2005 accord that ended the long-running secessionist war in Aceh. The rebels abandoned the fight for independence in exchange for a role in the politics of an autonomous Aceh. The compromise was helped by a number of factors. It followed the devastating tsunami of December 2004; the rebels were militarily weak; and Mr Yudhoyono's government may have wanted peace not just for its own sake but to diminish the army's political clout. Four years on, the province is hardly tranquil. Before the election in April three former insurgents were murdered in mysterious circumstances. But the fight now seems to be over the spoils of peace instead of presaging renewed war.

Papua, a treasure-house of mineral and timber resources, is more of a threat to Indonesia's international reputation. Forlorn separatists there are still locked up for unfurling flags. But the security forces themselves seem to be as much of a danger as the protesters. Human-rights groups have found a pattern of violence and torture familiar from the army's earlier campaigns. Killings near the huge Freeport-McMoRan gold and copper mine in July seemed as likely to be the result of a feud between the army, police and paramilitary forces as an attack by secessionists.

Solo performance

Elsewhere, devolution has had some successes. Local leaders such as Joko Widodo, mayor of the city of Solo in Central Java, and Herry Zudianto, his counterpart in nearby Yogyakarta, have done much to make citizens feel that it is in their democratic power to improve the often dreadful standard of public services. And devolution has given a chance to talented local leaders from outside the civil service or army. Mr Joko runs a furniture business, Mr Zudianto a chain of fashion shops.

But devolution has exacted a high price—in squandered resources, administrative confusion and, in some

instances, paralysis in decision-making. President Yudhoyono has called for a moratorium on the proliferation of new districts, the number of which has quintupled since 1951. The process often seems driven by the local elites' hopes of enriching themselves at the central government's expense.

Another difficulty is the separation between the sources of funds and the responsibility for spending them. Most public services are now provided by local governments, but 80-85% of their revenue typically comes from Jakarta, as it does in Solo and Yogyakarta. In part this is a result of an attempt to spread national wealth more evenly. In a second "big bang" reform in 2006, transfers to subnational governments increased by almost 50%, by the World Bank's calculation, mainly benefiting the poorer provinces. But local governments' shortcomings mean that this rarely translates into reduced inequality.

Decentralisation has left an administrative muddle. In particular, the role of provincial governments—which are also directly elected—is unclear. A recent report by the United Nations Development Programme describes them as the "missing link", awkwardly squeezed between central government, which has the money, and district and municipal administrations, which have the power.

The potential for wrangling is heightened by party politics. It is quite possible for a district to have a *bupati* from one party, a provincial governor from another and DPR representation from a third. All this may be messy, but not nearly as messy as the alternative that seemed a real prospect only ten years ago: a break-up of the Indonesian state.

Tolerance levels

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From The Economist print edition

Muslims in Indonesia may be becoming more pious, but not necessarily more extreme

AP



Relapse in Jakarta

ONE day in June 2007 Dago Simamora, a junior high-school teacher in Palembang in South Sumatra, picked up his nine-year-old son from school. On the way home he was shot dead. His killer scooted away on a motorcycle. The police at first blamed the murder on a land dispute. Only when the culprits were arrested a year later did it emerge that Mr Simamora had been killed because he was a Christian, accused of trying to convert the girls in his class. In April this year ten members of the Palembang jihadist group that killed him were jailed on terrorism charges.

Apart from this one "success", the group had a history of botched bombing and murder plots. But as the International Crisis Group (ICG), a think-tank, noted in a report, their story showed how easy it is for a group of law-abiding individuals to be drawn into terrorism. From peaceful beginnings as a study group worrying about Christian proselytising, its members progressed to violence (using a hammer, to start with) and became potential mass murderers. A crucial role was played by charismatic, footloose jihadists affiliated to Jemaah Islamiah (JI), a transnational South-East Asian group behind a series of bombings in Indonesia in the early 2000s, including the deadly Bali one in 2002.

Indonesia remains vulnerable to the violence of a fanatical fringe. After the bombings in Jakarta in July the police at once suspected JI or its offshoots and, in particular, Noordin Mohammed Top, a fugitive Malaysian, who had graduated from JI to form his own gang.

The unexpected attack raised questions about Indonesia's counter-terrorism policy. But that it was the first such bombing since 2005 suggested that the terrorists have become marginalised. Two new anti-terrorist squads have succeeded in breaking up JI cells, and reformed militants have helped with trying to "deradicalise" others by explaining the error of their ways to them, with mixed results.

Indonesia's main strength in fighting extremism, however, has been its own tradition of moderation and tolerance. Having absorbed influences from pre-Islamic faiths—Hinduism and indigenous beliefs—its version of Islam has been less doctrinaire than elsewhere in the Muslim world.

There has always been tension between this tradition and the efforts of some Muslim "modernists" to encourage greater orthodoxy. This is reflected in Indonesia's two great Islamic organisations. The traditionalist Nahdlatul Ulama (NU), with 40m-50m members, is strongest in the countryside. The modernist Muhammadiyah has some 35m members, mainly urban. By contemporary standards both are bastions of moderation. They are also huge enterprises. Muhammadiyah, for example, runs 14,000 schools, 169 institutions of higher learning, about 500 health centres including 171 hospitals, 700 orphanages and 400 microcredit institutions.

Both have considerable political influence. A former leader of NU, Abdurrahman Wahid, served a wayward stint as president from 1999 to 2001. His counterpart at Muhammadiyah, Amien Rais, a leader of the 1998 *reformasi* movement, also formed a political party.

Both parties are in Mr Yudhoyono's coalition, and hence contribute to the considerable Islamic input into policy formation. Neither did as well in the parliamentary elections as another Islamic party, the PKS. This started life as an underground student movement in the 1990s and is the one most feared by those who worry about the potential Islamisation of Indonesian politics. But the PKS is split, struggling to attract moderate, secular voters without alienating its core supporters. It did little better in this year's election than in 2004. And as a group, the Islamic parties saw their share of the vote fall from 38% to 29%.

Who cares about their hair?

In the presidential election there was a kerfuffle over claims that the wife of Boediono, Mr Yudhoyono's running-mate, was a Christian. It was noted that neither she nor the president's wife wears a headscarf. But on the whole religion was not an issue. Moreover, Jusuf Kalla, whom both Islamic organisations favoured for the presidency, seemed to make little impression on the voters.

Din Syamsuddin, Muhammadiyah's current chairman, takes comfort in the presence, among the 560 DPR members, of 161 with a "Muhammadiyah social background". Masykuri Abdillah, an NU vice-chairman, argues that the performance of the Islamic parties matters less now that "all parties promote religious values".

It is true that last year, when the first Yudhoyono administration was losing support to Miss Megawati's PDI-P, the Islamic parties were able to push it into backing two reactionary pieces of legislation. One was ostensibly meant to curb pornography but might also be used, for example, to ban traditional dances and thus persecute minorities. The second was a decree "freezing" the activities of the Ahmadiyah sect, a branch of Islam with adherents in many countries but seen as heretical by some Muslims. These capitulations suggest that less tolerant forms of Islam will gradually become more dominant in Indonesia.

If young people seem to be rejecting Islam at the ballot box, many seem to be more devout in their private lives. Growing numbers of women are wearing headscarves. There is a vogue for "Muslim only" middle-class housing estates. And some district governments have introduced *sharia*-based local laws (though in some cases, it seems, mainly in the hope of raising revenue from fines).

A more worrying type of Islamisation is the authorities' reluctance to stamp out violence by the Islamic Defenders' Front, or FPI. This group, founded in 1998, which the ICG says is "basically an urban thug organisation", has a record of bloodily intimidating Christians, Ahmadis and those offending its puritanical morality.

But liberal Muslims are getting organised too. Ulil Abshar-Abdallah, a founder in 2001 of the "Liberal Islam Network", takes heart from the Islamic parties' poor showing in the elections. He sees the Ahmadiyah ban and the anti-pornography law as Indonesian liberals'"Rosa Parks" moment, a reference to the birth of the American civil-rights movement. For the first time, he says, the disparate array of liberal groups has united in opposition to the new measures.

Both the Palembang group and the Jakarta bombers seem to have had ties to *pesantrens* (Islamic boarding schools) with JI affiliations. Sidney Jones of the ICG reckons there are about 50 such schools, but the authorities have let them be. The danger in Indonesia seems to be not so much the strength of Islamic extremism but the difficulty of confronting it in a free and tolerant political system.

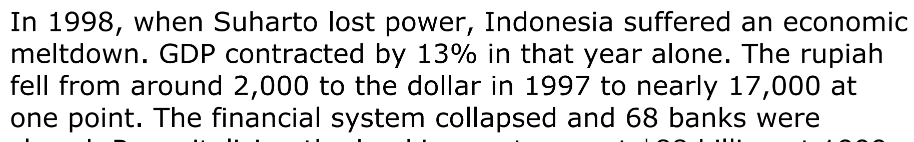
Surprise, surprise

Sep 10th 2009
From The Economist print edition

Never mind the risk premium, feel the stability



IN RUINS just a decade ago, Indonesia's economy these days seems a remarkably sturdy structure. Having been worse hit than any other by the Asian economic crisis of 1997-98, it has, by some measures, weathered the global slump of 2008-09 surprisingly well. Economic growth has slowed by less than in most other big countries. In part that is a gauge of its underachievement compared with faster-growing China and India. Indonesia's GDP growth will decline from 6.1% in 2008 and 6.3% in 2007 to perhaps 4% this year, compared with nearly 8% in China and 6% in India. But given Indonesia's starting-point a decade ago, that is still impressive.



In 1998, when Suharto lost power, Indonesia suffered an economic meltdown. GDP contracted by 13% in that year alone. The rupiah fell from around 2,000 to the dollar in 1997 to nearly 17,000 at one point. The financial system collapsed and 68 banks were closed. Recapitalising the banking system cost $88 billion at 1999 exchange rates, some 70% of GDP. Many businesses crumbled under the weight of their foreign debts. Tens of millions of Indonesians fell below the poverty line.

Recovery was unexpectedly quick. Annual growth averaged a respectable 5.4% in 2003-07 (though it did not regain the 6.5% average achieved for three decades under Suharto), and by 2005 GDP per person had recovered to its pre-crisis level of 1997. It is now over $2,200, higher than in the Philippines or Sri Lanka.

Yet, as global markets quivered in late 2008, the rupiah again came under pressure. In the six months from October 2008 the Jakarta Stock Exchange index fell by more than any other in Asia except Vietnam's. The spreads on Indonesian credit-default swaps, a measure of investors' perception of the riskiness of the country, soared to over seven percentage points. But this time the storm passed quickly. In the first half of 2009 the Jakarta stockmarket rose more than any other Asian market except Mumbai's and Shanghai's. By mid-2009 the rupiah had regained the bulk of its losses against the dollar.

Indonesia has found it easier to withstand the slump because its growth depends much less on trade than on domestic household consumption. Exports are equivalent to only about 25% of GDP, compared with over 100% in Malaysia in 2008. Moreover, Indonesia's exports remain dominated by oil, gas and, increasingly, palm oil and coal, so the country was less exposed to the sudden and drastic destocking that caused trade in manufactured goods in Asia to dry up in late 2008.

Sri Mulyani Indrawati, Indonesia's finance minister in Mr Yudhoyono's first term, thinks there are "more serious" explanations of Indonesia's resilience than its limited exposure to the global economy. More fundamental, she argues, are the reforms the government has put in place—improving legislation, simplifying regulations, reforming the bureaucracy and changing the pattern of government expenditure by cutting subsidies and investing more in infrastructure and education.

A different model

Miss Mulyani, one of Mr Yudhoyono's technocratic appointees, is much admired by foreign bankers and businessmen. Thanks to people like her, Indonesia has once again begun to be regarded almost as a model of a sensibly run developing economy, just as, incredible though it now seems, it was for much of the Suharto period. Wolfgang Fengler of the World Bank says that the most remarkable achievement has been to cut public debt from about 80% of GDP in 1999 to just over 30% at the end of 2008.

The secret of this success has been extreme fiscal restraint, despite an expensive devolution of power. The government has recently been running a budget deficit of around 1% of GDP, well below the legally mandated limit of 3%. In 2008 the budget was nearly in balance. In response to the global slowdown the deficit this year will be allowed to rise to about 2.5% of GDP, a very modest stimulus by international standards. In the budget for next year the deficit will come down again to 1.6%.

This shows admirable self-discipline but leaves the government open to two big criticisms of its fiscal management: that it is not spending enough money, and that it is spending it on the wrong things. The clearest measure of this is to look at some of Indonesia's "human-development indicators" (see table 3), which have improved markedly over the past 30 years. In 1980 life expectancy was only 52 years, and 10% of infants did not live beyond their first birthday. But the indicators are still far worse than they should be in a middle-income country, and not as good as those of Indonesia's regional neighbours. The maternal-mortality rate is particularly worrying, pointing to serious problems.

Carelessness costs lives 3

Country/ group	Life expectancy, years*	Infant mortality per '000 births*	Maternal mortality per 100,000 pop., 2005
Bangladesh	64	52	570
China	72	20	45
India	64	57	450
Indonesia	**68**	**26**	**420**
Malaysia	74	10	62
Philippines	71	24	230
Sri Lanka	75	11	58
Thailand	70	7	110
Vietnam	71	15	150
East Asia & Pacific	**67**	**35**	**286**
Lower middle-income countries	**68**	**34**	**233**

Source: World Bank *Latest available

One reason is the misdirection of public money. Despite Miss Mulyani's boast about cutting subsidies, the most important of which lower the price consumers pay for fuel and electricity, they still account for about a quarter of all government expenditure. Indeed, if non-discretionary spending—transfers to the regions, interest payments and so on—is excluded, subsidies make up 51% of what is left, without even counting farm subsidies.

Fuel subsidies are political dynamite. When they were cut at the IMF's behest in early 1998, the ensuing riots helped bring Suharto down. Miss Megawati twice had to back down from reducing them. Mr Yudhoyono has been bolder, better prepared and perhaps luckier, twice cutting the subsidy in 2005 and then again in 2008 as the oil price soared. But the fall in the oil price early this year was passed on to consumers, missing a chance to reduce the subsidy further. In defence of this decision, Miss Mulyani has one limp argument—that consumers have to get used to fuel prices going both up and down—and one unanswerable one—that, so close to an election, no one will tackle subsidies.

The politics may be intractable, but they are based on a fallacy. Subsidies in Indonesia, as elsewhere, go disproportionately to the rich. According to the World Bank, only 10% of Indonesian fuel subsidies benefit the poor. Consumption even of kerosene, the cause of the 1998 riots, mostly increases with income.

The difficulty is not just the lack of funds for better-directed public spending. It is, in Miss Mulyani's words, that "the ability to spend is not there." The central government has never been good at disbursing budget allocations, and lower-level governments are worse. Many are sitting on huge cash balances because they lack what she calls "the administrative and institutional capacity" to invest properly in infrastructure and public services. A recent drive against corruption may have added a further brake: in a system prone to inertia, doing nothing looks less suspicious than doing a lot.

So Indonesia's credit-crunch stimulus was unusual in coming mostly in the form of tax cuts. Spending promises might well have gone unfulfilled. But Indonesia urgently needs more and better spending on its transport and power-generation infrastructure and public services, and on health care and education.

How to spend it

Government spending on health, at less than 1% of GDP, is low compared with other countries in the region. And there are far too few doctors—just 21 per 100,000 people, extremely low by world standards. But an even more fundamental problem seems to be that resources are unevenly distributed across the archipelago, and are poorly and sometimes corruptly administered. Standards of training and monitoring health professionals are woeful.

A public health-insurance scheme for the poor, known as Jamkesmas, now covers about 76m people, nearly one-third of the population. But Ajriani Munthe Salak, of the Legal Aid Foundation for Health, says that the poor often have to pass through a bewildering series of bureaucratic hoops to receive treatment.

Still, half of all health spending is private, and Indonesia is a long way from agreeing on how to pay for its ambition of introducing a system of universal health care, by extending Jamkesmas to the entire population by 2012. In the meantime the financing of health care, like that of all public services, has been complicated by decentralisation, and the provision of care appears to be worsening.

One of the great assets Indonesian democracy inherited from dictatorship was almost universal access to primary education and very high levels of literacy. This is also a tribute to the success of Indonesian, the Malay-based national language, spoken as a mother tongue by very few Indonesians at the time of independence, yet now in use in almost every village. According to Juwono Sudarsono, a former education minister, the 1998 financial crisis forced 3m children to drop out of school. But this year primary-school enrolment rates are still about 95%.

The constitution requires the government to devote one-fifth of its spending to education. It has never met this target, but may come close this year, promising free education for all children—though in practice this will not be available everywhere. The need now is to produce better-trained teachers, help children in poorly served remote areas and help and encourage more children to stay on at school for longer. Enrolment rates for secondary and tertiary education are low: 60% and 17% respectively, compared with 69% and 29% in Malaysia, for example.

More than a single swallow

Sep 10th 2009
From The Economist print edition

The rise of Chindonesia

Alamy



Come nest in me

THE best-maintained building in the remote village of Teluk Binjai in Riau province on Sumatra is neither the new, rather Spartan, wooden mosque nor one of the better-off local farmers' stilt-raised bungalows. It is the home for swallows. A windowless structure, it is studded with rows of dozens of gleaming access chutes. Tapes of alluring music tempt the flighty gadabouts to make themselves at home. Their health-giving nests, once harvested, fetch between 8m and 15m rupiah per kilo in Pekanbaru, the provincial capital, and far more still when they reach their destination: China.

China's voracious consumer appetites are already reaching into every corner of Indonesia. Even in Bali, the country's main tourist destination, the numbers of Chinese visitors are fast catching up with those from Australia and Japan. The increasing weight of China in every market is a global trend, but growing Chinese, as well as Indian, demand is making an especially big impact in Indonesia. Nick Cashmore of the Jakarta office of CLSA, an investment bank, has coined a new term to describe this symbiotic relationship: "Chindonesia".

Indonesia's pivotal role in this new "golden triangle" is as the supplier not only of birds' nests but of two even more vital commodities: palm oil and coal for power stations. Indonesia is now the world's largest producer of palm oil, having overtaken Malaysia in 2006. China and India between them already account for one-quarter of world consumption of palm oil and more than one-third of world imports. The area covered by Indonesia's palm-oil plantations has increased from 1m to 6.5m hectares.

Indonesia enjoys a big cost advantage over its main competitor, Malaysia, as it does over Australia in coal for power stations, another commodity where demand, led by China and India, is expected to grow hugely. Already, in the past 15 years, Indonesia's coal exports have grown at a compound annual rate of 15%. Last year its exports reached 190m tonnes, compared with Australia's 126m.

Indonesia's exports to "Chindia" made up 14% of its total exports last year, more than those to America (10%). Trade with China in particular is developing apace. Sino-Indonesian relations were frozen for a quarter of a century from 1967 after the massacre of suspected communists, including many ethnic Chinese, after Suharto's rise to power. Ethnic-Chinese Indonesians dominated big business, but even the display of Chinese characters was forbidden. Now the two countries like to boast of their "strategic partnership".

In March China provided a yuan swap facility worth some $15 billion. This was both insurance against another run on the rupiah and part of China's experiment with using the yuan as an international currency. Indonesia is one of the countries where it is to try to start settling trade in yuan. Indonesian companies such as Sinar Mas, a big palm-oil exporter, say the central bank has sounded them out on their readiness to do so.

The relationship is not all sweetness and light. In July Muslim groups protested outside the Chinese embassy after the clashes with ethnic-Uighur Muslims in Xinjiang in China. Merpati, an Indonesian airline, has been in dispute with a Chinese supplier over its contract to buy 15 propeller aircraft. And Indonesian textile firms are lobbying against the full implementation from next year of the free-trade agreement between China and the Association of South-East Asian Nations.

Not making it easy

Sep 10th 2009
From The Economist print edition

Why business in Indonesia has yet to take off

THE Suharto clan infected Indonesian business like a pandemic virus. Its direct business interests included power generation, toll roads, electronics, plastics, timber, paper, an airline, a taxi company, construction, fishery, food processing, broadcasting, banking, telecommunications, newspapers, plantations, property, shipping, cars and mining.

Besides its own investments, the family, and the mostly ethnic-Chinese tycoons through whom it acted, also played a vital agency function in awarding big foreign contracts. The system had its defenders. Even a senior World Bank official noted that although a toll road built by a Suharto family enterprise might cost 20% more than it should, at least it got built. As corrupt systems go, it was relatively effective—rather like China's. But few outside the charmed Suharto circle mourn its collapse. The meltdown brought both a big increase in foreign ownership of Indonesian firms and a huge improvement in openness and management standards.

Some of the old groups survive. One, the Bakrie conglomerate, accounts for about a quarter of the trading on the Jakarta Stock Exchange. It came close to extinction both in the late-1990s crisis and in 2008. Its patriarch, Aburizal Bakrie, successfully straddled the Suharto and Yudhoyono regimes. But Bakrie is no longer typical. Its heavy weight on the exchange mainly reflects the thinness of the stockmarket, with a capitalisation at the end of last year equivalent to just 20% of the country's GDP, against 65% in Malaysia.

However, even a reformed Indonesia remains a hard place to do business, both for local entrepreneurs and, especially, for foreign investors. Fauzi Ichsan, an economist with Standard Chartered Bank in Jakarta, lists six main obstacles: legal uncertainty; the confusion brought by regional autonomy; tax problems; dealing with the customs agency; inflexible labour laws; and infrastructure. He says the ranking of these problems by his bank's clients has shifted. The top concerns used to be the law and decentralisation. Now the second-biggest worry is the labour market. Top of the list, however, is infrastructure.

Indonesia's roads, air- and seaports are inadequate. Electricity generation lags demand. Only 18% of the population have piped water and only 2.5% are connected to a sewerage system. Total investment in infrastructure, including that by the private sector, was estimated at just 3.9% of GDP in 2007, compared with about 10% in China and Vietnam.

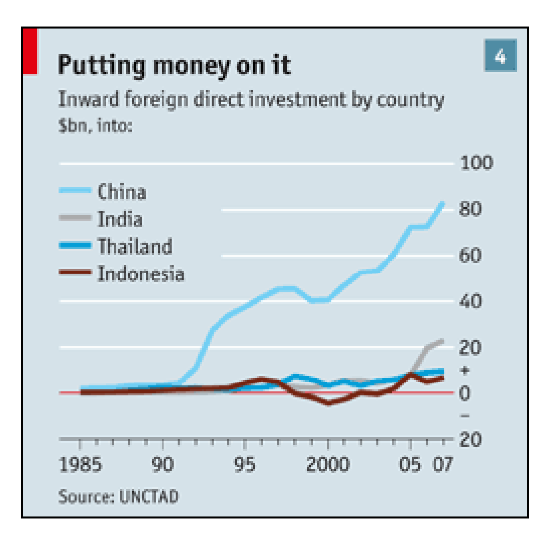
Traffic gridlock looms in the big cities, especially Jakarta, where the number of motor vehicles has tripled to 9.5m in the past eight years but road space is growing at less than 1% a year. Construction of a mass rapid-transit railway is due to start in 2011, but with the number of passengers expected to reach just 400,000 a day by 2020 it will hardly ease the congestion.

A crash programme of power generation is not keeping up with demand, which has been growing by more than 6% a year for the past decade. PLN, the state power company, has been trying to encourage private-sector investment, but subsidised electricity acts as a disincentive. Tariffs have not increased since 2003. During the oil-price boom of 2008 they did not even cover the cost of the fuel burned in Indonesia's power stations.

Export industries are hampered by a lack of ports. Shipping costs are between 50% and 80% higher than elsewhere in the region. An estimated $20 billion needs to be invested over the next five years, but efforts to draw up—let alone implement—a master plan for port development have foundered on the decentralised structure of government. Every district wants its own port, and some projects make sense only as tokens of national pride. For example, plans to develop Batam, an island designated as a special industrial zone, as a container terminal to rival nearby Singapore seem a waste of money. The whole point of choosing Batam for development was its proximity to Singapore.

Besides the competing interests of provincial and district

governments, infrastructure development also has to contend with the difficulties of land acquisition. In the Suharto years land was often grabbed; now Indonesia has to make its grand plans within the constraints of a democracy.



Foreigners' Desultory Interest

In this respect, it is now less like an East Asian tiger than it is like India, another country that struggles to build the infrastructure it needs in the muddle and frustration of a democratic society. Also like India, until recently at least, it has failed to attract foreign direct investment in anything like the volume that has poured into China—or indeed, as a percentage of GDP, other countries in South-East Asia (see chart 4). FDI in Indonesia has averaged a mere 0.5% of GDP in recent years, and that includes a few very large items, such as BP's $5 billion natural-gas project in Papua.

Indonesia has not managed to draw investment in the sort of labour-intensive manufacturing for export that fuelled China's boom. This is to squander a great comparative advantage: a labour force that is young, literate and cheaper than anywhere else in the region.



It does not help that Indonesia is suspicious of foreign investors. It posts a protectionist "negative list" of industries where FDI is capped, including pharmaceuticals, health care and construction. And it is constantly embroiled in disputes with foreign firms. In March, for example, an international arbitration panel ordered Newmont Mining, of America, and Sumitomo, of Japan, to sell some of their shares in a big copper-and-gold mine on Sumbawa island. And in June it banned imports of some models of BlackBerry smartphones, made by Canada's Research In Motion.

A deep-rooted habit

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From The Economist print edition

The difficulty of battling graft

EVEN before passing through immigration into Indonesia, you may fall prey to the venal flair of its bureaucrats. Most of its embassies now refuse cash payments for visas, after a number of scandals. One ambassador in Malaysia, a former police chief, allegedly pocketed about 2 billion rupiah from unauthorised visa surcharges. But many visitors can now get visas on arrival, payable in cash. To close this tempting window, Ngurah Rai airport in Bali last October introduced an electronic visa-issuing system. By May this year officials at the airport had used it to steal an estimated 3 billion rupiah. Their ruse, to issue 30-day visas, which cost $25, but book them as seven-day ones at $10, was simple and, until spotted, lucrative. The story is typical of Indonesian officialdom's greed, but also of the increasing efforts to thwart the corrupt.

The most effective weapon is democracy itself. Mr Yudhoyono's honest image is a big factor in his popularity. His running-mate, Boediono, is famously incorruptible. His campaign drew Goenawan Mohamad, a veteran and vigorously independent writer, into politics for the first time as an adviser. More than anything else, says Mr Goenawan, Mr Yudhoyono's legacy should be a clean government.

The introduction since 2005 of direct elections for local officials has also spawned a new accountability. Herry Zudianto, mayor of Yogyakarta, runs one of Indonesia's cleanest and most efficient administrations. Already mayor for five years when he faced an election in 2006, he was so popular that at first no candidate could be found to run against him.

Like Joko Widodo, mayor of the nearby city of Solo, Mr Zudianto has introduced "one-stop shops" for business permits. The previous long paper trail might require a bribe at every stop. In Solo, civil servants, in uniform, now sit behind open counters rather than in discreet booths, which forces them to conduct their business in full view. Mr Joko reckons that the cost of an identity card used to be between 25,000 and 100,000 rupiah; now it is a flat 5,000 rupiah. Applications for places at secondary schools are now made and adjudicated online, cutting off a nice little earner for officials at the better schools.

That, however, raises a question: how should honesty be rewarded? In the central government, bureaucratic reform was tested in Sri Mulyani Indrawati's finance ministry in 2006 and proved a great success in improving performance and cutting corruption. But to be able to pay staff properly for good, honest performance, a special new allowance had to be created, which has resulted in a fivefold increase in the take-home pay of some of the civil servants there.

Mr Joko says he cannot sack miscreant or incompetent civil servants, nor can he reward outstanding ones. He envies the reported initiative of the *bupati* of nearby Sragen, who curbed graft and increased local-government revenue by installing CCTV cameras to monitor a weighbridge and gave the officials involved a share of the tolls. But he sees no legal basis for it.

Alimin Siregar, an expert on decentralisation at the University of Riau in Pekanbaru, in Sumatra, claims that local democracy has succeeded mainly in devolving money politics. Local elites induce their local DPR member to sponsor a new district. When it is created, central-government money starts flowing. Stealing some of it allows those elites to recoup their investment and enrich themselves further.

A couple of hours outside Pekanbaru, two gleaming new palaces stand incongruously in the middle of nowhere. One is the assembly for the local legislature of Pelalawan district. Next door is the *bupati*'s mansion. He is currently in jail convicted of corruption over logging concessions.

A gecko among crocodiles

Besides the ballot box, the other big weapon against corruption is the Corruption Eradication Commission, known as the KPK, an independent body formed in 2002 that has considerable powers. Its trophies include several DPR members, a police chief, provincial governors, city mayors, a central-bank governor and,

among several other central-bank officials, one whose son is married to Mr Yudhoyono's daughter. Only one of the KPK's own investigators has joined this select band, incurring a 30% supplement to his jail term, in accordance with his contract of employment. The KPK, which deals only with big cases, has managed to make the perpetrators of some of the more egregious instances of public robbery a mite nervous.

It is, however, in some trouble. In April its chairman was jailed for suspected murder, prompting lurid stories of an alleged love triangle involving an attractive golf caddie. More seriously for the institution, the DPR has been talking about whittling away its powers—against which, says Mr Goenawan, "all democratic forces of spirit should scream".

Some such spirited forces took to the streets of Jakarta in July, calling themselves "Cicak", the Indonesian for gecko, but also an acronym for "Love Indonesia, Love the KPK". This was a reference to a remark by a senior policeman that the KPK's investigators, in tapping his telephone, were "like geckos trying to fight a crocodile".

The behaviour of the police is one reason why Indonesia's ranking in Transparency International's (TI) annual Corruption Perceptions Index for 2008 improved only marginally on the year before, from 143rd out of 179 countries to 126th out of 180. According to a report this year by Amnesty International, a human-rights watchdog, the police in Indonesia—separated from the armed forces as one of the first big acts of reform in 1998—"are still perceived today as a highly corrupt and mistrusted institution". Officers, it noted, "often behave as if they are above the law".

Haryono Umar, one of the KPK's commissioners, does not dispute Indonesia's poor showing in TI's league table. It is based on perceptions. And most Indonesians, not unreasonably, perceive an encounter with the police or with a government official as costly.

Acacia avenue

Sep 10th 2009
From The Economist print edition

How to save Indonesia's dwindling rainforests

Still Pictures



Where tigers roam no more

AS A spectacle, the four-hour drive to Teluk Binjai from Pekanbaru, capital of Riau province on the island of Sumatra, tends to the monochrome. Mile after mile of palm-oil plantation alternates with mile after mile of regimented lines of acacia trees, grown for pulpwood. Only an occasional banana grove or superannuated rubber plantation offers a spot of variety. Mountainously laden timber lorries ply the interprovincial highway, their loads of acacia logs almost brushing as they pass. In one direction is the mill of Indah Kiat Pulp and Paper, a subsidiary of APP, part of the Sinar Mas group; in the other that of APRIL, Sumatra's other big pulp-and-paper producer.

Off the main road, small patches of "natural" forest survive alongside the swathe of broad sandy corridor cut by a logging company. Some has been cleared fairly recently. Shrouded in white smoke, the peat soil still smoulders under the blackened tree-stumps. Gaunt and barkless, some trees still stand, like skeletal ghosts stalking a battlefield. Underneath, already oil palms are pushing up, planted by local farmers to feed Indonesia's latest commodity boom.

In Teluk Binjai, a village of 400 families sprawling along the bank of the Kampar river, and its neighbour, Teluk Meranti, farmers feel squeezed. Living inside a logging concession, their access to the forest behind their farms is already curtailed. They want to be granted rights to 5,000 hectares of forest on the other side of the river, in the Kampar peninsula. This area of 700,000 hectares of peat forest, home to tigers, sunbears, hawk-eagles and other endangered species, is now being fought over by plantation companies, forest residents and local and international NGOs.

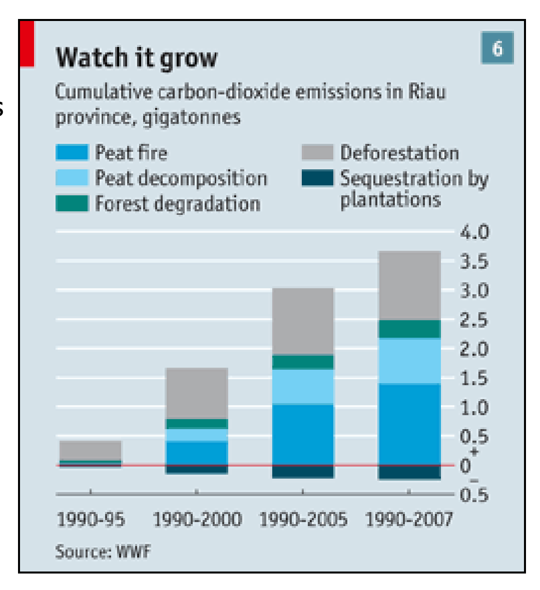
The stretch the villagers have their eye on is also part of a concession. They admit they have no legal right to the land, but they say the concession to convert it to acacia is illegal, since the area is supposedly protected. And the villagers claim customary rights. Their families have used the forest for generations. They still depend on it for rattan, fuel, honeybees, hunting and wood to build their houses and boats. But they use the resource responsibly, claims Muhammad Yusuf, a local farmers' leader: "We only take the best trees." And no more than they need.

Illegally, some farmers are already staking out claims across the river in the sought-after stretch of forest. One, in his second year there, says the village chief in Meranti granted him a six-hectare claim after his coconut grove in Teluk Binjai was destroyed in a land-clearing fire. He is planting oil palms. Speaking in a tiny hut, against the whine of a chainsaw from the nearby rainforest, he says he is too poor to send his 12- and 14-year-old sons to school. They are working in his fields, helping convert another small patch of peatland, and adding to Indonesia's alarming emissions of carbon dioxide.

Stop it, for peat's sake

Indonesia's logging of its rainforests has long been identified as a big contributor to the world's emissions of greenhouse gases (GHGs), and hence to global warming. This is one reason for the shocking statistic that Indonesia trails only China and America as an emitter of carbon. But now attention is also turning to the soil beneath the trees, and especially to peat. Al Gore, a former American vice-president and a vigorous climate-change campaigner, has pointed to evidence that the top two metres of soil contain three times as much carbon as the entire vegetation on the planet, and that soil degradation, such as the burning of peatland, is the main cause of Indonesia's high level of emissions.

According to Greenpeace, an environmental NGO, Riau's peatlands have the highest concentration of carbon stored per hectare anywhere in the world. As elsewhere in Indonesia, peat in Riau is disappearing. The trees growing on it are harvested and the land is either abandoned or converted to a plantation. Every year 1.8 billion tonnes of GHG emissions are released by the degradation and burning of Indonesia's peatlands. By the calculation of WWF, an NGO, between 1990 and 2007 Riau alone produced more CO_2 per year than Germany is saving to meet its commitments under the Kyoto protocol.



Small-scale settlers like those clearing the bit of forest opposite Teluk Binjai are a tiny part of the problem. Far more significant, in Riau ("the deforestation centre of Indonesia", according to Yumiko Uryo of WWF) and across Indonesia, are large-scale commercial operations: illegal logging and the conversion of forest land by big plantation companies. By WWF's estimate, of the forest cover in Riau lost in the past 25 years, 29% was cleared for palm-oil plantations and 24% for pulpwood by the big producers themselves—not counting large areas cleared by their suppliers.

The extent of illegal logging, like every other statistic on Indonesia's forests, is disputed. By one reckoning, 73% of the $1.6 billion-worth of forest products (not including raw logs, whose export is banned) the EU imported from Indonesia last year came from illegally felled timber. But that is a guess, derived by deducting the timber that can be shown to be legal, a process complicated by the often murky ownership of the original forest lands. The Indonesian government reckons that no more than 10% of exports are illegal. It is working with the EU to devise a licensing system for timber exporters which would then be applied globally. Indonesia also faces difficulties in America. Congress, inspired by an unlikely coalition of domestic timber producers and NGOs, last year amended the Lacey act, a law dating from 1900 that bans the illegal commercial transportation of wildlife. It now covers the produce of illegal logging as well.

Protection of the forest against illegal loggers and enforcement of the law are said to have improved since 1997, when forest fires in Sumatra and Kalimantan (Indonesian Borneo) smothered much of South-East Asia in a noxious, choking haze. The fires were spread by a prolonged drought brought by an El Niño weather pattern. Many were lit to clear land illegally logged. And even now the legal arrival of a logging company in an area is often accompanied by criminals chopping away at the edge of the concession. Decentralisation has complicated efforts to enforce the law. Local authorities resent efforts by the central government to assert control.

Hotspots of bother

Indonesia's government denies it is doing as much to cook the planet as its critics allege. Agus Purnomo, a former director of WWF in Indonesia who now heads the secretariat of the National Council on Climate Change, says that the country's third place in the carbon-emissions tables is a hangover from the disastrous El Niño of the late 1990s. With no serious forest fire for four years, he claims Indonesia has slid down to number 15 or 20. He reckons that the "hotspots" (small-scale forest fires) recorded this year—3,764 in Riau alone by July, according to a count by satellite—are "not a big issue". Hotspots are now designated as crime scenes, he says, so that no one is allowed to plant oil palms there. If caught, those who caused them are prosecuted and sometimes jailed.

He points out that it is in Indonesia's own interests to do its bit to reduce GHG-emissions and hence global warming. A study this year by the Economy and Environment Programme for South-East Asia, based in Singapore, mapped vulnerability to climate change across the region, divided into 530 subnational districts. Of the ten most endangered by climate change, seven were on Indonesia's most populous island, Java, which would become increasingly prone to droughts, floods, landslides and a rise in the sea level.

Even more immediately, Riau, for example, is suffering a localised haze at the moment. It is not quite the eye-stinging, throat-burning, aviation-disrupting peasouper seen in 1997, but still the town of Dumai recorded a surge in acute respiratory illnesses in June and July.

Blucher Doloksaribu, who heads the provincial government's Geophysical, Climatology and Meteorology Board, reckons Riau is already suffering its own local, accelerated version of global warming. As forest cover has shrunk from 78% in 1982 to 27% today (see map), minimum temperatures in Riau have increased, he estimates, by an average of 2ºC.



After a de facto two-year moratorium for an investigation into alleged corruption, logging has resumed in earnest in Riau this year. Green activists link this to the elections and the need for parties to raise funds.

The big pulp-and-paper and palm-oil companies have several lines of defence against attacks from greens. Responding to growing concern about the impact of palm-oil plantations, the big producers and consumers have joined a round-table on sustainable production. The firms insist that they do follow the law, logging only the "production" forests for which they have bought concessions. But their critics allege that they also buy from less scrupulous subcontractors, and that this year the pressure is especially intense since the moratorium had forced pulp companies to eat into their plantation forests earlier than they would normally have done.

The firms also defend their own practices as responsible and sustainable. Sinar Mas, for example, has set aside some 72,000 hectares (an area bigger than Singapore) of "production forest" as a protected "biosphere", where the trees and wildlife will be preserved. Some even argue that palm-oil and acacia plantations can actually help reduce GHG emissions, though scientists scoff at this notion when the plantations are on cleared natural forest and, especially, peatland.

But Gandhi Sulistyanto, Sinar Mas's managing director, also points to the huge economic benefits his business brings Indonesia, directly and indirectly supporting millions of people and producing more than one-tenth of Indonesia's exports. More than half of Sinar Mas's exports go to China and India. So, despite boasting of his firm's green credentials, and his concern for minimising carbon emissions and saving biodiversity, he cannot conceal his impatience with NGOs: "They care about the orang-utans [which are indeed threatened by the spread of plantations], not the *orangs* [people]."

The great green hope: REDD

Mr Sulistyanto hopes Sinar Mas's biosphere in Riau may yet bring the firm some income from an initiative known as Reduced Emissions from Deforestation and Degradation (REDD). This is an idea that sounds almost too sensible to have gained currency. Since developed countries have become rich partly by cutting down their trees, and since old forests are better at storing carbon than new ones, it seems fair for the rich world to pay the poor world to stop logging (rather than, as at present, merely to plant new trees, under the so-called Clean Development Mechanism). There is a lot to preserve. More than half of Indonesia is still covered in forest. Sumatra may be a lost cause, like much of Kalimantan. But there is still, for example, Papua.

REDD forms part of the negotiations on a successor to the Kyoto protocol, which will reach a climax at meetings in Copenhagen this December. The idea may be better known in Indonesia than anywhere else. Businesses are already earmarking scraps of their concessions; Merrill Lynch, a big American investment bank, is nurturing a project; less established "carbon traders" are setting up shop in Indonesia; villagers in places like Teluk Binjai have visions of leisurely retirement at the international taxpayer's expense; and the government is creating a complex bureaucratic infrastructure. The forestry ministry has already issued rules on the sort of conservation projects that might be eligible, as well as guidelines on splitting the

revenue.

But so far forest carbon credits remain a small, voluntary market. Gordon Brown, Britain's prime minister, has said a deal at Copenhagen should include transfers of $100 billion a year to the developing world, which would include funds for preserving forests. But there are plenty of question-marks still: the price of carbon, for one thing; how the money should best be used; and whether it would really be paid in perpetuity.

Agus Purnomo of Indonesia's climate-change council is a sceptic. He finds it hard to believe that the sort of money needed to compensate for the loss of deforestation revenue would be forthcoming. The range at present under discussion—$3-10 per tonne of carbon emissions saved—would be wholly inadequate. He agrees with many that the main point of Copenhagen must be "deep, deep cuts" in rich-world emissions. "You cannot leave saving the atmosphere to poor people."

So it is not easy to be optimistic about Indonesia's forests. Ahead of big international gatherings the government makes big promises. It has, for example, banned the conversion of land where the peat is more than three metres deep. But green groups say that hardly helps, since peat bogs have varying depths, and draining a shallow part will erode the rest. The commercial pressures are bound to grow. The conversion of acacia and eucalyptus as cellulose for biofuels will add a new market, and the development of palm-oil micro-refineries will make it much easier to get the fruit to a refinery within 24 hours of harvesting. Perhaps most urgently, a renewed El Niño is brewing, threatening drought and devastating forest fires.

For the government, carbon emissions will become an ever more galling issue. Just as the country seems ready to take its place on the international stage, gaining credit for its peacefulness, its stability and its pluralism, it will find itself under attack, however unfairly, as a vandal on a planetary scale.

Everybody's friend

Sep 10th 2009
From The Economist print edition

Indonesia deserves a better image

AP


Secretary-of-state visit

IN MOST other respects this is a golden age for Indonesian diplomacy. Its relations with its neighbours are sometimes prickly, especially with Malaysia, with which it squabbles over everything from maritime boundaries to the treatment of migrant workers. And there will always be some resentment of Singapore, a regional haven for the wealthy and, at times, a bolthole for fugitives from Indonesian justice. But these two are also partners with Indonesia in the Association of South-East Asian Nations (ASEAN), so they are among its closest allies. In general Indonesia is on good terms with all countries.

Its international standing has risen. Besides being an applicant-in-waiting for what would become the BRIIC group of leading emerging markets, it is a member of the G20 group of countries that is taking on more responsibility for running the world. It is seen as a democratic bulwark against extremist Islam, and as a vital American ally. Hillary Clinton included Indonesia on her first foreign tour as secretary of state. President Barack Obama, who spent four years at school in Jakarta, is due to visit, probably in November. As already noted, China and India are also courting Indonesia. So are Japan and the European Union, which in July lifted a ban on four Indonesian airlines on safety grounds, removing a big irritant.

As much the most populous country in South-East Asia, and its biggest economy, Indonesia has always played a dominant role in ASEAN. The regional group, after all, was founded in 1967 partly to contain Indonesia after a confrontation with Malaysia that stopped short of war. But under Suharto Indonesia led by stealth, through the power of veto, rather than as ASEAN's public face. Now there are signs that it may become more assertive, and in an encouraging way—speaking up for the importance of democracy and human rights in a group that is too often prepared to soft-pedal, especially over Myanmar.

As ASEAN moves towards greater economic integration at glacial speed, Indonesia has a belated chance to position itself as a regional hub. Officials like to point to this year's decision by Volkswagen of Germany to assemble cars in Java for the ASEAN market. The underlying argument is that Indonesia, because of the size of its domestic market, should be the logical destination for foreign investors looking for a base within ASEAN from which to attack the regional market. But so far firms have rarely chosen Indonesia for such a role.

One reason is the range of obstacles to doing business cited earlier in this report, from unreasonable nationalism through endemic corruption and administrative confusion to appalling infrastructure. Another is Indonesia's image problem. It suffers unfairly from an outside perception that it is a risky and unstable place. An instructive comparison is with India, which has seen far more violent and intractable insurgencies—from Kashmir on the periphery to Maoist Naxalites in its very heart. It is also prey to many more frequent and murderous terrorist attacks, and has testy relations with a nuclear-armed neighbour. Yet, in stark contrast to Indonesia, it is considered a bastion of stability.

Some Indonesian thinkers, meanwhile, are looking beyond ASEAN. Rizal Sukma, of the Centre for Strategic and International Studies, a Jakarta think-tank, has argued that good relations with its neighbours in ASEAN should not be the country's only concern. His call for a "post-ASEAN foreign policy" reflects both frustration with the caution shown by the regional group and a sense that it is time for Indonesia to adopt a higher profile.

With luck, it will. It has already shown remarkable powers of recovery after a long dictatorship and economic collapse. It could become a model of democratic change, Muslim tolerance, poverty eradication and rapid economic development.

As this report has shown, at present all of these are at best work in progress. The country is still struggling to meet its interlinked goals of sustained economic prosperity and political stability. But it is inching closer, and its chances of getting there have never been better.

Sources and acknowledgments

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Mergers and acquisitions make a comeback

The return of the deal

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A new merger wave may be forming, with lots of companies' shares still at relatively cheap prices

EPA



THERE is nothing like a good bidding war to lift capitalism's spirits. And that may be exactly what is about to happen after Kraft made a $17 billion bid for Cadbury on September 7th. The venerable British confectioner rejected out of hand the American food giant's offer, saying it "fundamentally undervalues" the company, which could continue to thrive on its own. Kraft's management said it would be disciplined, but intended to pursue a hostile bid. This triggered speculation that other big food companies, such as Nestlé, Hershey and Mars, might enter the fray, perhaps as a "white knight" that would help Cadbury maintain its independence—or, at least, give it up on more advantageous terms.

Kraft's move is one of several in recent days that have raised hopes of a new wave of mergers and acquisitions just as it seemed, after a summer of inactivity, that 2009 would be a moribund year for M&A. On September 8th Deutsche Telekom and France Telecom said they would merge their British mobile-phone operations, respectively T-Mobile and Orange, to create a new market leader. The same day Vivendi of France said it was buying GVT, a Brazilian mobile-phone firm, for €2 billion ($2.9 billion). On August 31st Disney bought superhero factory Marvel Entertainment for $4 billion, and Baker Hughes offered $5.5 billion for its fellow Houston-based energy-services firm, BJ Services. The next day eBay sold a 65% stake in its internet-phone unit, Skype, for $1.9 billion, to a group of private-equity investors.

Perhaps this will prove to be nothing more than a dead-cat bounce, a brief flurry of long-overdue deals that were held back until senior executives and investment bankers returned from the beach. After all, dealmaking had fallen to unnaturally low levels in the aftermath of last year's financial panic and subsequent economic slump, so a burst of post-summer action was always a possibility without it necessarily implying a turn in the cycle. Until the Disney and Baker Hughes deals, August was shaping up to be the worst month for M&A since 1995, according to Dealogic. (It was still the worst month since 2003.) To the end of August, the total value of deals worldwide was just short of $1.5 trillion, 36% lower than at the same stage last year, and 56% below what it was at the end of August 2007, the record year.

Yet hopes are rising that the recent spate of deals might indicate a genuine turning point in the merger market. "While it is not yet evident in the statistics, the level of corporate dialogue has picked up recently," says Christopher Ventresca, co-head of North American M&A for JPMorgan. One reason is that

many firms now think systemic risk in the financial system has fallen to a low level. Another, he says, is that they have done the defensive work needed to shore up balance-sheets after last year's panic: refinancing debt where necessary and making sure that they have plenty of what the crisis revealed as the possible difference between corporate life and death—financial liquidity.

With that sorted out—thanks, not least, to a dramatic reopening of the debt markets, at least for more creditworthy companies—managers are trying to figure out how to expand their businesses in what forecasts suggest will remain a lacklustre economy for years, at least in rich countries. Buying growth from outside, rather than generating it organically, may be the easiest option. There is also a momentum effect in M&A, especially as the cycle turns. "Seeing some well-known firms start to do deals will create more confidence in others," says Mr Ventresca.

Share prices are also now in a sweet spot for a revival of deals, says David Bianco, an equity strategist at Bank of America Merrill Lynch. They have rallied decisively enough to inspire confidence that the worst is over, yet valuations are still depressed by historic standards and when compared with past recoveries from financial crises. In other words, there are bargains to be had.

Big is back

Health care and technology, the two industries that have seen the most merger activity during the recent downturn, are likely to remain strong, says Mr Bianco. Nowadays, if a hardware, software or services firm is not one of the ten or so industry giants, it faces a difficult future—which is why the likes of Oracle and IBM are finding increasingly willing sellers among small and medium-sized technology firms.

Consolidation in financial services, which has been growing because of bankruptcy and rescue acquisitions, will henceforth increasingly be the result of choice, not necessity. Regional banks, smaller trust banks and asset managers will realise that their best strategy is to be bought by one of the 15 largest finance conglomerates, with a market capitalisation of over $20 billion. Mr Bianco, who has clearly been spending too much time in Starbucks, calls these "venti financials".

Cyclical industries such as retailing and food manufacturing may also see lots of mergers and takeovers. Having cut costs drastically, many firms in these industries can look forward to decent cashflow; as their confidence returns they may invest this cash in acquisitions to boost growth.

If there is a new merger wave, a much larger proportion of the deals will be strategic than in the wave that ended in 2007. In other words, the deals will combine firms in the same industry, such as the putative Kraft-Cadbury marriage, or allow a firm to take advantage of its existing strengths, such as a presence in a particular region or a distribution network, by adding new products—as with Disney's purchase of Marvel, which will add its archive of 5,000 characters to Disney's own.

One reason strategic deals are likely to be more common is that managers may be less resistant to selling in the current, more risk-averse environment: it may be better to bank a merger premium now than to hold out in the hope of a better offer later. A second reason is the decline of private-equity firms, which in the carefree credit-bubble era that ended in 2007 were outbidding even strategic buyers who were able to generate instant cost-savings or revenue growth. The Skype deal is unlikely to signal a resurgence of private equity. Two of the main buyers, Silver Lake Partners and a new venture-capital firm recently launched by Netscape's co-founder, Mark Andreessen, are technology specialists that make little use of debt—in sharp contrast to classic private-equity buy-out firms such as Kohlberg Kravis Roberts.

Although the credit markets have reopened, they are not yet ready to finance high-yielding leveraged buy-outs, by private equity or anyone else. This is likely to be the main brake on more merger activity. The debt that is available is no longer "covenant lite", and is likely to be forthcoming only for buyers who are willing to pay a large chunk of the purchase price with their own equity. Even those companies that could raise large amounts of debt are unlikely to do so. Some lessons, at least, have been learnt from the recent crisis.

China's struggling smaller firms

Small fish in a big pond

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They do more for China’s economy than big firms—but get less help

Alamy



Surviving through the ages—but without much help

CHINA’S massive, state-backed firms are becoming ever more visible on the world stage, but the country can trace a great deal of its recent economic success to countless small and medium enterprises. Today, as China continues to grapple with the effects of the global slowdown, these smaller firms are enduring a large share of the economic pain.

Virtually non-existent in 1979 when China took its first steps away from central-planning orthodoxy, its smaller companies numbered around 1m by 1990 and 8m by 2001. Today they total around 60m. The smallest have just a handful of workers, and the largest of the medium-sized ones, according to the government’s definitions, employ no more than 2,000 people. Yet together they account for 60% of China’s GDP and half its tax revenues. More than 95% are privately owned and, since they are largely free of the political and bureaucratic friction that plagues larger enterprises, they are among the most creative and nimble of China’s economic actors. They are responsible for 66% of the country’s patent applications and more than 80% of its new products.

They are also responsible for 68% of China’s exports, and it is this last figure that has made the current hard times especially difficult for them, as foreign demand has sagged. China has long sought to rebalance its export-driven economy toward a greater role in supplying domestic consumption, and if declining demand in America and other big export markets helps prod it along that path, that will represent a silver lining to the current gloom.

In the short term, however, smaller firms’ fortunes are lagging. An alarming set of official figures showed that the consumption of power by China’s smallest industrial enterprises declined by half in the first half of this year. Only after recovery will it be clear whether this reflects widespread devastation among small industrial firms, or simply a prudent tendency to slow production temporarily in the hope of surviving the crisis.

But it is China’s labour-intensive smaller firms rather than its energy-intensive ones that most depend on exports, and there is no ambiguity about the difficulty they face. Chinese exports began declining last November and the government reckons that poor export performance knocked 2.9 percentage points off the growth rate in the first half of this year. The government also cites the decline in exports as an important factor in the loss of 20m jobs held by rural workers who had migrated to urban and industrial centres.

According to Connie Zheng of Australia’s Royal Melbourne Institute of Technology, hard knocks are nothing new for the smaller firms, which often bear the brunt of negative trends in China. In the decade since China began paying more attention to environmental regulation, for example, smaller firms have been far more likely than larger ones to face costly enforcement measures or closure. They have likewise drawn the short straw in the government’s response to the economic crisis. One part of that response was the 4 trillion yuan ($586 billion) stimulus package launched last November, but much of this has been directed toward the sort of infrastructure projects that are dominated by large state-owned enterprises.

According to Joerg Wuttke, president of the European Union Chamber of Commerce in China, state firms have been the “big winners of this crisis”. Monopolies, he says, are only getting more entrenched and big state firms are crowding out the smaller players China will ultimately need to sustain growth.

Another longstanding challenge for smaller firms has been poor access to credit, and although another part of the government’s crisis response has been a massive boost in bank lending, they have again been shut out. Of more than 7 trillion yuan loaned out in the first half of this year by Chinese banks, only an estimated 10% has gone to smaller firms.

Much of China’s bank lending remains politically driven, putting state enterprises at a great advantage. Smaller firms have fared little better with lending decisions made on commercial terms. It is not without justification that banks often view smaller businesses as bigger credit risks, and China’s credit-rating system remains too poorly developed to benefit even the more solvent ones. This, according to Ms Zheng, has forced them to rely either on informal financing from friends and family, or on black-market lending schemes for which interest rates can be far higher than official bank rates.

There are fresh signs that officials recognise the need to level the field. State news media this month reported plans for new measures aimed at improving access to capital for smaller businesses, including the establishment of two dedicated investment funds totalling 4 billion yuan. That, alas, is a mere pittance in the context of this year’s broader lending spree. It is not easy being small.

Economist.com BUSINESS

The World Bank's Doing Business report

Reforming through the tough times

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A World Bank report makes surprisingly cheerful reading

WITH falling sales, rising public indebtedness and surging anti-business sentiment, the past year has been a tough one both for business people and for pro-business policymakers. "It is not just a crisis of the economy," says Mahmoud Mohieldin, Egypt's minister of investment. "It is a crisis of economic thinking. It is a crisis that is confusing many reformers."

Even so, the World Bank's annual Doing Business report*, which tracks changes to the regulations that affect business, suggests that governments have handled the storm well. In the year since June 2008, 131 countries introduced 287 pro-business reforms—20% more than in the previous 12 months and more than in any year since the World Bank started the survey in 2004.

Low and lower-middle income economies accounted for two-thirds of the action, with Rwanda turning out to be the world's champion reformer—the first time a sub-Saharan country has claimed the prize (see table). Eastern European and Central Asian countries were the most energetic reformers by region for the sixth year in a row (26 out of 27 governments there introduced reforms). Middle Eastern and North African countries were not far behind (17 out of 19 countries), and 17 high-income countries also spruced up their business regulations.

Encouragingly, reform seems to be contagious. Countries try to emulate leaders in their regions. Many African governments, for example, have taken note of the success of Mauritius's deregulated economy. They also respond to competition. Germany introduced laws to make it easier to establish joint-stock companies, scrapping ancient regulations, because so many German companies were taking advantage of the single European market and incorporating in Britain. Amazingly, given the fiscal pressure on governments, only one country increased its corporate income-tax rate: Lithuania, from 15% to 20%.

Doing better

Ease of doing business, fastest reformers

Country	2010 rank*	2009 rank*
Rwanda	67	143
Kyrgyzstan	41	80
Macedonia	32	69
Belarus	58	82
United Arab Emirates	33	47
Moldova	94	108
Colombia	37	49
Tajikistan	152	164
Egypt	106	116
Liberia	149	159

Source: World Bank *Of 183 countries

How much does all this reform matter? A good deal, according to a growing body of academic literature (so far there are 405 articles in academic journals and 1,143 working papers devoted to studying the impact of the Doing Business reforms). Lower barriers to entry are associated with a smaller informal sector. Informal businesses have lower wages, lower growth rates, poorer safety records, tend not to pay taxes and are prey to corruption. Reducing the cost of doing business leads to higher rates of growth and entrepreneurship.

One study shows that, in poor countries, a ten-day reduction in the time it takes to start a business can lead to an increase of 0.4 percentage points in GDP growth. Another shows that people who have a formal title to their property invest as much as 47% more in their businesses.

It often takes a shock to set the reform machine in motion. Several countries that have been racked by civil wars, including Rwanda, Afghanistan and Sierra Leone, have brought in new company laws. The best reformers have several things in common. Their reforms are part of a broad agenda of boosting competitiveness. Over the past five years such pace–setters as Rwanda, Egypt, Colombia and Malaysia have each implemented at least 19 reforms. And they never stop. Those paragons Hong Kong and Singapore introduce substantial reforms each year.

The willingness of governments to keep reforming in such tough times strengthens the prospects for recovery. Sensible regulations not only make it easier for new firms to get started, but also help established firms change direction and clapped-out firms declare bankruptcy.

But there is no cause for complacency. Businesses in low-income countries struggle with twice the burden of regulation as those in high-income countries. Developed countries have an average of ten times as many newly registered businesses for every adult as countries in Africa and the Middle East. Almost two-thirds of the world's workers are still employed in the informal sector. The World Bank's latest progress report, optimistic though it is, is a reminder of how far there is still to go in getting business regulations right.

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*Doing Business 2010, World Bank. www.doingbusiness.org

Economist.com BUSINESS

Employers spying on staff

Big Brother bosses

Sep 10th 2009
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More than ever, companies want to know what their employees are up to

Alamy



Your every keystroke, silently logged

IF THE workers at Japan's Keihin Electric Express Railway Company seem unnaturally cheerful for drizzly autumn mornings, it is because they are being watched. The firm has installed cameras with special scanners at 15 of its stations to measure employees' smiles, ensuring that harried commuters are always greeted with a grin, however forced.

It may seem extreme to Western eyes but it is just one example of a business that is booming: employee monitoring. Companies have long kept a close eye on employees to maintain productivity and guard against theft. But the economic downturn has prompted some to redouble their efforts—and advances in technology have given them the means.

A recent report from Gartner, a consultancy, found that spending on security software rose by 18.6% to $13.5 billion in 2008. The market for security information and event management software (SIEM), which can be used to mine e-mails for keywords and security breaches, grew by 50% according to Gartner. The fastest-growing area is network forensic software, which lets firms record and playback exactly what happens on employees' computer screens, and can even record keystrokes.

Gartner's John Pescatore says the software is "like a giant TiVo" or "a security camera pointed at a till in a bank". This niche doubled in value between 2007 and 2008, from $25m to $50m. Mr Pescatore predicts that the market will jump another 50% by the end of this year.

Companies use this kind of software, for example, to monitor employees who are about to leave, whether through redundancy or choice, to make sure they do not take sensitive information with them. Managers can spot the moment that an embittered salesperson copies a client database onto a flash-memory stick.

Financial-services firms are particularly vulnerable to the enemy within. The case of Sergey Aleynikov, the Goldman Sachs banker accused in July of stealing high-frequency trading software worth millions of dollars to the bank, was an illustration of the huge value of intellectual property that is at risk of going astray.

Companies also use monitoring software to protect employees from themselves. Malicious software often infects a corporate network by exploiting security holes in web browsers to infiltrate a PC when its user visits a dodgy website. Compromised machines can then be linked up to form "botnets" under external control, which are used to send spam e-mails or disable websites with a flood of bogus requests. When Procter & Gamble ran a security check of its 80,000 PCs, it found 3,000 were infected with botnet software.

Another use of employee-monitoring software is measuring productivity. Managers trying to decide who to make redundant can use forensic software to catch that slacking YouTube addict red-handed.

Even workers on the road are not safe from prying corporate eyes. Several start-up companies, such as Purewire and Zscaler, have launched software to monitor employees outside the company network. Workers accessing the internet from hotel rooms using a company laptop may be surprised to find their web browsing is being monitored by the IT department back in the office. Their page requests flow through a web monitoring service, which can block or report access to certain sites.

Monitoring software can also be used to spot “presenteeism”—employees who turn up in the office every day but then do nothing. Peter Cheese, managing director of Accenture’s talent and organisation practice, says that presenteeism has become more common as communications break down between managers and staff in firms that are under financial stress.

But although workforce-monitoring software may provide what seems like useful information, it is no help when it comes to addressing the problems it uncovers. It may also undermine morale and mutual trust. Mr Cheese warns: “If you have to check up on employees all the time, then you probably have bigger issues than just productivity.”

 BUSINESS

The travails of Turkey's Dogan Yayin

Dogan v Erdogan

Sep 10th 2009 | ISTANBUL
From The Economist print edition

Turkey's biggest media group gets a colossal tax fine

IS IT an attempt to muzzle the press or a simple matter of punishing a tax-dodger? Public opinion remains divided as the battle between Turkey's mildly Islamist government and its biggest media tycoon, Aydin Dogan, rages on. The row took a dramatic turn this week when Mr Dogan's conglomerate, Dogan Yayin, was slapped with a staggering 3.75 billion lira ($2.5 billion) fine for allegedly evading taxes in the transfer of assets from one of its companies to another.

Mr Dogan's finances have already been strained by an 826m lira tax-evasion fine levied in February, linked to a €422m ($609m) sale of shares to Axel Springer, a German media giant. A Dogan official admits to fears that it could go bankrupt but, late on September 9th, its shares rallied on hopes it could reach a deal with the tax authorities. Turkey's tax laws are notoriously complex. "They can be used as a spear or a shield," says a foreign analyst, who says there is insufficient evidence to back the claims of a vendetta against Mr Dogan.

It is no secret that Turkey's prime minister, Recep Tayyip Erdogan, and Mr Dogan do not get along. Mr Dogan's stable of newspapers and television channels has promoted claims that Mr Erdogan is bent on leading Turkey towards religious rule. Their coverage was used as evidence in a court case seeking to ban his Justice and Development (AK) party, which was overturned last year.

A furious Mr Erdogan called on AK members to boycott Mr Dogan's papers. Rumours are swirling that Mr Erdogan wants Mr Dogan to fire various hostile columnists in exchange for clemency. Dogan-owned companies are swarming with tax inspectors. "The message from the government to everybody, is that if you go after me I'll go after you," comments one Dogan-employed journalist. According to the conspiracy-theorists, this explains why Mr Dogan's fellow industrialists have not rallied to his support even though his daughter, Arzuhan Yalcindag, presides over Turkey's biggest business lobby, TUSIAD.

Mr Erdogan denies singling out Mr Dogan for punishment. Since AK came to power seven years ago, two other media conglomerates—one of which, SABAH, is Mr Dogan's chief rival—have gone into receivership over fraud charges against their owners. Mr Dogan was keen to buy SABAH. Despite there being no evidence of impropriety there was an opposition outcry when the firm instead went to Ahmet Calik, a rival whose firm is co-managed by Mr Erdogan's son-in-law.

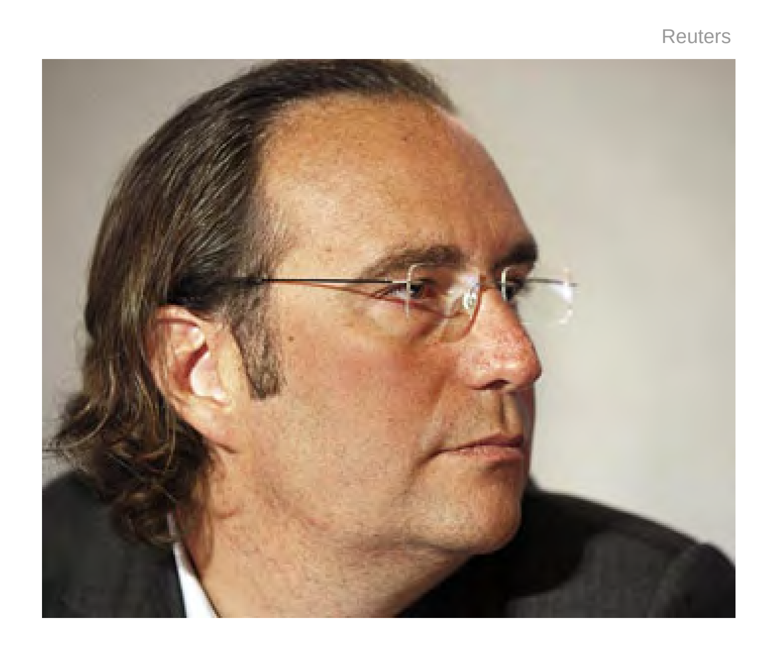
Face value

Iliad's warrior

Sep 10th 2009
From The Economist print edition

The rise of Xavier Niel, a controversial internet entrepreneur, says a lot about French business

Reuters



“IF I commit suicide, or if I die in a car accident in the next three months or so, you will know the threats were serious, because I am not feeling at all suicidal and I drive very slowly.” Xavier Niel, the founder of Iliad, a young broadband firm which has upended France’s internet-access market and wants to do the same for mobile telephony, says he is prepared for any attempts at intimidation. In 2004 an executive from TF1, a French television firm which was withholding its programming from Iliad’s multimedia packages, reportedly told one of Mr Niel’s colleagues: “I am going to nail you down on the wall in blood.”

He may be a bit paranoid, but Mr Niel plans to wreak financial violence on France’s dominant telecoms firms. After years of deliberation and fierce opposition from the big three—Orange, owned by the former monopoly, France Telecom; SFR, part of Vivendi, a media giant; and Bouygues Telecom, part of a conglomerate which also part-owns TF1—the government invited bids for a fourth mobile licence on August 1st. If Iliad wins, as is expected, it aims to launch a service under its brand, Free, by 2012. By halving prices and lifting limits on the length of calls, Mr Niel hopes to take a big slice of the market. If he succeeds, says Nicolas Didio of Exane BNP Paribas, a stockbroking firm, Iliad could eventually lift its operating profit by 50% while cutting profits at Orange by 10%, at SFR by 17% and at Bouygues Telecom by 23%.

Mr Niel points out that mobile-phone prices are strikingly similar in France. He says that French operators have the highest profit margins in Europe, and an iPhone costs much more in France than in Austria or Britain, for example. To preserve their comfortable position, the incumbents have lobbied using themes which resonate with politicians—that lower profits could trigger job cuts, strikes and more outsourcing to Asia. One operator is running an internal “Tout Sauf Free” project, working on ways to keep Iliad out, says Mr Niel, who with his long hair and casual clothes might seem more at home in Silicon Valley than France’s stuffy corporate scene.

Mr Niel fears ruthless tactics may be used to thwart the creation of a powerful rival to the big three. For instance, it would be cost-efficient, he says, given the billions of euros at stake, for one of them to let another bidder pay the €240m ($344m) for the fourth licence, then buy the firm. “It’s bizarre when a supposedly competitive market has to prepare itself so aggressively for a new entrant,” he remarks.

Mr Niel’s worries may in part stem from the fact that he is the ultimate outsider in French business. An

entrepreneur from the age of 16, he succeeded without family money or a university education. He went into the sex business first, creating chatline services on Minitel, a data network which predated the internet. He invested in a series of sex shops and in 2004, just a few months after Iliad's successful initial public offering, he was briefly held in prison when one of them was discovered to be a front for prostitution. In the end he was fully exonerated of having known what was going on, but was fined for receiving money from the shop. The affair has created something of a stigma around Mr Niel in top business circles, says a former colleague.

Nevertheless, his record as a consumer champion has made him popular with competition authorities, industry regulators and some politicians. The OECD reckons that consumers are indeed charged much higher mobile-telephony prices in France than the average among its 30 members. In broadband, by contrast, France has the cheapest prices, because of Iliad's entry into the market in the early 2000s, says Taylor Reynolds, an OECD economist. In 2003, in "unbundled" regions (ones where Free could install its own broadband equipment alongside France Telecom's infrastructure), it priced a package of broadband at 2 megabits a second, free local and national calls plus television at €29.99 a month. France Telecom's Wanadoo, the market leader, was at the time offering broadband at half the speed, with no other features, for €39.90. Within a few years Free's rivals had all introduced similar bundles at around the same price. Iliad also pushed its competitors to innovate, says Mr Didio; it was the first, for instance, to launch an internet-television service.

The judgment of Paris

To their credit, France's authorities have backed Mr Niel all the way from broadband into content and now mobile telecoms. Observers wondered whether the friendship between Martin Bouygues, the boss of Bouygues Telecom's parent, and President Nicolas Sarkozy might block a fourth licence. But those on the side of competition proved too strong to resist. France Telecom and Bouygues Telecom, which paid far more (€619m) for their mobile licences, will complain to the European Commission over what they argue is state aid to Iliad.

Conquering mobile will be harder than Iliad's entry into broadband. The market is mature and many customers are locked into long-term contracts. Because of health worries about mobile-phone masts in France, Iliad may find it tricky to build its network. A fight has already broken out over whether it has the right to install its own antennae in roof spaces being rented by its larger rivals. One risk, says Mr Didio, is that Free will roll out its network too slowly and will have to pay expensive fees to the big three for keenly priced calls outside its network.

"In business terms, Xavier Niel is a great self-made entrepreneur alongside Bernard Arnault, François Pinault or Serge Dassault," says a Paris-based banker who knows Iliad well. With a difference: Messrs Arnault, Pinault and Dassault made their money from old-world businesses—luxury goods, retailing and fighter jets. Mr Niel, who owns 66% of Iliad's shares, is already France's only information-technology billionaire, on paper at least. If he succeeds in disrupting yet another market, the establishment may finally have to acknowledge him.

Economist.com OPINION

Wall Street's new shape

Rearranging the towers of gold

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From The Economist print edition

Wall Street has staged a surprisingly strong recovery from its meltdown a year ago. But it will not return to business as usual

Illustration by Ian Whadcock



AT THE press of a button, the double doors sweep open. Welcome to the office in downtown Manhattan of Lloyd Blankfein, chief executive of Goldman Sachs. A couple of years ago, such smooth gadgetry would have seemed a fitting symbol of the power of Wall Street. These days it stirs more sinister thoughts: of a screen villain rather than a hero of high finance. As it happens, it is rumoured that an institution not unlike Goldman will appear unflatteringly in Oliver Stone's sequel to "Wall Street", due in cinemas next spring.

Economists continue to debate the ultimate causes of the collapse of Lehman Brothers, Wall Street's fourth-biggest firm, a year ago on September 15th, and of the havoc that followed. The public and most politicians, however, are clear: the blame lies with bankers, venal and incompetent in equal measure. "It's like pre-Thatcher Britain out there," sighs the head of a New York bank. At a hearing in February a congressman addressed JPMorgan Chase's boss, Jamie Dimon, as "Mr Demon". Deliberate or not, it captured the mood.

The name-calling may have died down a bit lately, but the Street will struggle to regain its swagger. Reforms proposed by Barack Obama's administration would, if passed, introduce an array of penalties for bigness and boldness. Regulators, too, are determined to clip finance's wings, even musing about reducing the "swollen" financial industry to a more acceptable size (see Buttonwood), a sentiment echoed by self-flagellating bankers. This week the arch-capitalist Mr Blankfein chastised Wall Street for letting "the growth and complexity in new instruments outstrip their economic and social utility". Reducing banks' leverage and their leeway to splash out on star traders will be a priority at the G20 summit in Pittsburgh this month.

The politicians are driven in part by populist urges and in part by a genuine wish to avoid a repeat of the week in which global finance suffered a near-fatal heart attack. In the space of two days Merrill Lynch fell into the arms of Bank of America (BofA), Lehman went bust and American International Group (AIG), a mighty insurer, buckled under suicidal derivatives bets and had to be bailed out. Lehman's demise marked the onset of the worst financial crisis and global recession since the 1930s.

To be sure, the seeds of trouble had been sown years earlier, with the relaxation of lending standards in mortgages, corporate buy-outs and much more, and with the enthusiasm for using borrowed money to enhance returns. The debts of American financial firms rose steadily from 39% to 111% of GDP in the 20

years to 2008. But many of the subsequent policy choices—not least the $700 billion Troubled Asset Relief Programme—stemmed from Lehman's demise.

Some believe there would have been less pain had Lehman been bailed out. Others think it was coming anyway (see Economics focus). Either way, the episode shattered market expectations that large firms would not be allowed to fail—a few months before, the stricken Bear Stearns, New York's fifth-biggest investment bank, had been forcibly married to JPMorgan. With no one sure who could be trusted, lending froze, most abruptly in short-term markets, such as that for commercial paper, that many had come to rely on to support long-term assets. Such was the panic that the government was forced to backstop supposedly rock-solid money-market funds. By October the large, free-standing investment bank, the pride of Wall Street little more than a year earlier, was extinct.

Among the most important decisions was that no other big financial firm would be allowed to suffer Lehman's fate. The consequences were too frightening. This approach extended to the stress tests for 19 "systemically important" institutions, completed in May. Those found wanting were promised capital from taxpayers if they could not tap private sources.

The aftershocks of September 2008 are still being felt, not least by the firms at the centre of it. Although chunks of Lehman were sold quickly to Barclays of Britain and Nomura of Japan, tens of billions of dollars of clients' cash, much of it belonging to hedge funds, is still trapped in the world's biggest bankruptcy. AIG is part way through a tortuous dismemberment.



America's financial-services industry has shed record numbers of jobs as firms have failed, been sold or retrenched (see chart 1). Life has become less gilded for those still at their desks: Wall Street bonuses fell by 44% last year (chart 2). For the first time in living memory, investment bankers are having to pinch pennies: taxi firms in Bedford, a wealthy New York suburb, say business at local railway stations has evaporated because Wall Street commuters are walking, cycling or being picked up by their spouses instead.

Hence the relief at recent signs of stabilisation. Stockmarkets have rebounded. Investors have regained their appetite for junk-rated debt: the amount issued hit a two-year high in the week to August 14th. The interest rate at which banks lend to each other has fallen back to near pre-crisis levels. Large-scale bank nationalisation is off the table. Though hundreds of smaller banks face extinction, big banks have thickened their buffers against loss by raising common equity. The healthiest have repaid public capital (at a profit to taxpayers). Confidence is growing among discerning investors: hedge funds, the bane of wobbling banks last year, have lately been buying their shares, not shorting them.

Fuelling this optimism is a partial revival of capital markets. Overall activity remains muted, private securitisation markets all but shut. But trading and underwriting have picked up as capital- and credit-hungry firms tap into the thawed market—though volume has fallen since July (see chart 3).

Still nice if you can get it

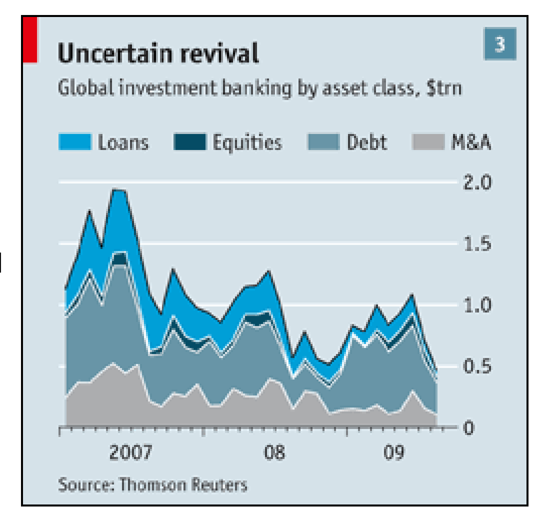
Wall Street firms': *total bonuses, $bn* / *average bonus, $'000*

Source: Office of the State Deputy Comptroller, New York

Survivors prepared to take risks have done very well from trading in currencies, commodities and so forth as clients adjust their portfolios to new market realities, such as higher volatility. Bill Winters, co-head of JPMorgan's investment bank, calls it "the most profitable period ever for continuing operations". Banks have begun adding staff in hot areas, notably commodities. Some are even offering guaranteed bonuses, believed only months ago to have vanished with the go-go years.

These trading profits look unsustainable. Indeed, dealers' spreads are already coming down as shell-shocked rivals recover their poise. Moreover, the financial system continues to be underpinned by federal programmes. Issuance of securities backed by consumer assets, such as car loans, has come back from the dead, to roughly $100 billion since March, but only thanks to a financing facility run by the Federal Reserve. "I still think in terms of parachutes rather than green shoots," says Rodgin Cohen, chairman of Sullivan & Cromwell, a law firm.

This support means that the minting of money this year in banking's top tier—the latest quarter was Goldman's most profitable ever—leaves a bad taste. "Wartime profiteering," harrumphs an industry consultant. Kenneth Rogoff, a Harvard economist and an authority on financial crises, argues that Wall Street's resurgence merely reflects a temporary arbitrage: systemically important banks can make big profits taking big risks with cheaply borrowed funds, thanks to the taxpayer's "invisible wallet" in the form of guarantees, while the authorities turn a blind eye.



Some may even be gambling for salvation. The banks that lost most, such as Merrill and Royal Bank of Scotland, have been offering the keenest terms in several areas, such as leveraged lending and rights issues, say rivals. This jostling for custom is benefiting some clients. BofA Merrill Lynch, Deutsche Bank and Credit Suisse recently agreed to delay part of their fees for initial public offerings by two property trusts. The balance will be payable only if the trusts make a minimum return on equity for a set period.

Swallow and hope

One threat the big names face is from boutiques and others looking to capitalise on the turmoil. Merger and restructuring shops have been hiring, touting their independence and freedom from regulatory interference. KKR, a private-equity firm, is expanding its capital-markets unit and has begun underwriting share offerings, starting with firms in its own portfolio. Private-equity groups should also benefit from the planned easing of restrictions on their ownership of banks. Several former rainmakers and star analysts have set up broker-dealers.

There is a big vacuum to fill, argues John Costas, a former UBS bigwig who has just co-founded PrinceRidge, a boutique focused on debt markets. Some $15 trillion of financing capacity has been taken out as banks have shrunk balance-sheets and the "shadow" network of non-bank credit has crumbled, he estimates. Demand has fallen too, but not by that much.

The newcomers could yet struggle. Far from ceding ground, the big banks have grown even bigger, aided by government-brokered mergers. Rules have been bent or broken: JPMorgan breached the 10% market-share ceiling for deposits when it took over Washington Mutual, for instance. According to *Inside Mortgage Finance*, a newsletter, nearly half of American mortgages made in the first half of the year came from Wells Fargo, which took over Wachovia, or BofA, which swallowed Countrywide.

Increased concentration is vexing for regulators. Because systemically important firms can borrow more cheaply thanks to implicit state backing, small and medium-sized banks struggle to compete. A recent Fed study put big banks' funding advantage at more than 30 basis points. That leads to another possible problem: indiscipline. Private firms with a low cost of funds and the taxpayer behind them are prone to recklessness: just look at Fannie Mae and Freddie Mac. America's leading banks were too big to fail before the crisis. Now they are bigger still.

On closer inspection, however, the giants are taking divergent paths. In one camp are those at the top of Wall Street's new pecking order, Goldman Sachs and JPMorgan. With them are other "flow monsters"—firms with a big share of high-volume markets, such as currencies, fixed income and equities—including Barclays and Credit Suisse. Like others, these giants have been forced to reduce their leverage, but they see a future that is not so different from the past. Goldman has been boldest, taking record amounts of risk last quarter—though mostly for client trades, not its own book, it insists. Mr Blankfein believes his firm will be able to continue making markets, financing deals and co-investing with clients. "Being both a principal and an agent is mutually reinforcing," he says.

Perhaps, but these days making a fortune can be as invidious as losing one. Goldman's bumper profits and earmarking of $11.4 billion for staff in the first half of 2009—not a record, but close—have turned the media as well as the mob against it.

Illustration by Ian Whadcock

The firm's chutzpah has not helped. It declared that it could have survived without federal assistance, and that it did not need the taxpayers' cash it received as a derivatives counterparty of AIG

because its positions were hedged. Goldman has been put on the back foot by a spate of negative stories, including one that compared it to a vampire squid. (These creatures, which grow to only six inches, are "small and harmless rather than carnivorous," says an exasperated Mr Blankfein.) Keen to deflect criticism, Mr Blankfein this week attacked some of the industry's pay practices and accounting shenanigans, even calling for a ban on multi-year guarantees, which Goldman insists it does not offer.



Goldman's arch-rival, Morgan Stanley, takes a markedly different view of Wall Street's future. Having ramped up its risk-taking in the boom—John Mack made higher leverage an explicit goal after becoming its boss in 2005—Morgan Stanley has spent the past year scuttling in the opposite direction. The firm has hired traders in some areas to take advantage of the rally after the dramatic cutbacks of last year, but it now sees its future primarily in conventional "agency" businesses that require relatively little capital, picking up fees for arranging mergers, underwriting securities offerings and broking—to which end it bought a controlling stake in Smith Barney from Citigroup.

Citigroup, too, is returning to its roots. Forced by regulators to shrink after losing tens of billions on collateralised-debt obligations, it is well on the way to shedding 40% of its assets. The new, more modest model, centred on things like retail banking and managing companies' cash, is essentially the Citicorp that existed before its mammoth merger with Travelers in 1998, with a few exceptions, says Vikram Pandit, Citigroup's boss.

This renewed focus on old-fashioned finance is spreading. Consulting firms say they have seen a surge of interest from banks keen to sharpen their service in everything from retail banking to prime brokerage (the financing of trading by hedge funds). Bob Gach, head of the capital-markets practice at Accenture, a consultancy, knows of several that have set aside $400m or more to improve their technology links with customers. "Relationships are back," he says. Investment banks are also throwing more resources into merger and restructuring advice, neglected by some during the boom as "a mere pimple on the donkey's arse", as one veteran puts it, but now seen as a core source of revenue—with limited downside.

Much of this comes in anticipation of new rules designed to curb bankers' wilder instincts. With Congress fixated on health care, the fate of the Obama administration's sweeping financial reforms remains unclear. Banks are in anxious limbo, awaiting the fine print on the treatment of securitised mortgages, credit-default swaps and more. But no one doubts that changes are coming.

The most dramatic is likely to be a toughening of capital-adequacy standards, endorsed recently by G20 finance ministers and a group of central bankers and supervisors that oversees the Basel capital rules (see article). The new rules could be ready for adoption by the end of next year. The Basel Committee has already proposed higher capital charges for complex trading and exotic securitisations.

Capital will also be the method of choice to rein in firms big enough to rock the system. American officials are reluctant to go nuclear and break them up, not least because the task of splitting them into pieces small enough to pose no danger would be horribly messy. Instead banks will probably face a sliding scale, with minimum capital ratios rising as they get bigger or embrace more risk. They will also be expected to prepare "living wills", setting out how they could be liquidated in the event of failure.

"There's a real risk we end up so laden with capital that we can't waddle and fart at the same time," says a Wall Street grandee. Scrutiny from supervisors, increased after Lehman, will remain heavy. Goldman Sachs has no fewer than 40 Fed staffers breathing down the necks of its traders and risk-modellers.

Supervisors may have a valuable role in dealing with excessive pay, too. Britain's Financial Services Authority may have watered down its pay code after bankers whinged about losing talent, but it has been using moral suasion to good effect, calling bosses to express its displeasure at the re-emergence of guaranteed bonuses. "Only the very bravest ignore a call like that," says JPMorgan's Mr Winters.

Supervisors, boards and shareholders (who are finally getting a say on pay in America) are likely to have a more beneficial impact on pay practices than rules crafted by politicians, who tend not to think the consequences through. When Congress increased the tax on bonuses earlier this year, banks predictably began raising fixed salaries to compensate. The compromise on pay reached by the G20 is more

measured, but mostly proposes things big banks are already doing, such as paying more restricted stock and clawing back bonuses if performance slumps.

Elsewhere too, re-regulation may have regrettable unintended results. The push to standardise over-the-counter derivatives contracts, for instance, could, if taken too far, leave investors trying to hedge specific risks with blunt instruments, making the system less safe, rather than more.

The eventual size and shape of a re-regulated, rethought Wall Street is hard to predict. The industry has always been a bit like a balloon: squeeze it in one place and it expands in another. Sure enough, banks are making the most of today's conditions: Credit Suisse, for instance, is structuring mortgage securities that are unrated by credit-rating agencies; it and others have begun securitising life-insurance policies that the old and infirm sell for cash.

Not-so-great expectations

However, the days when finance accounted for 40% of corporate America's profits are over. Mr Winters thinks investment banks' average return on equity will settle at a hardly dazzling 10-12% (though the best firms will do much better than that). At leverage of 15 times equity—the reduced level at which investment banks now typically operate—large parts of the fixed-income business fail to cover their cost of capital, reckons Brad Hintz, an analyst with Alliance Bernstein.

Rising interest rates will provide further drag—and probably ensure that credit grows more slowly than the economy for some years. "Everyone was running downhill for 15 years," says Michael Poulos of Oliver Wyman, a consultancy. "Now we'll see who the real athletes are."

Making fiscal policy credible

Bind games

Sep 10th 2009
From The Economist print edition

Can governments bolster confidence that they will act to prevent a debt spiral?

Illustration by S. Kambayashi



A YEAR on from the collapse of Lehman Brothers, the world economy is turning the corner. The plunge in output at the end of last year and in the early months of 2009 has been arrested. The economies of America, Britain and the euro area now seem to be growing again. Policymakers are cautious and in no hurry to withdraw stimulus. The European Central Bank (ECB), for instance, will again offer unlimited one-year loans to banks at its main interest rate, of 1%, on September 30th.

Still, with the worst economic news now behind them, officials are under increasing pressure to explain how they will reverse course when the time comes. That task is particularly hard when it comes to the public finances. Fragile economies need support from fiscal policy, but it is harder for finance ministries than central bankers to promise credibly to be strict in future when they are so liberal today.

Scarcely any rich country has stable public finances. America's public debt is expected to double as a fraction of GDP by 2018. Britain faces many years of budget deficits and a rising debt burden. There is no end in sight for deficits in the rest of Europe either. An obvious danger of large and persistent deficits is a loss of faith in governments' ability to cap the rise in debt. If bond markets become concerned that governments could default or inflate away their debts, interest rates would jump, choking off recovery.

One way to bolster trust would be to put fiscal policy on the same footing as monetary policy, by outsourcing budgetary decisions to independent councils with a mandate to preserve fiscal solvency. That would not be easy. Central bankers have just one instrument, the short-term interest rate, and one main task, to control inflation (although financial stability is now being added to their plates). They are granted long terms in office to ensure they are free from interference.

Fiscal policy is far more complex. There are as many objectives as there are tax rates and spending schemes. Politicians have to seek re-election and their success depends partly on how well they spend and how cleverly they tax. These are inherently political choices. An administration willing to comply with fiscal rules could not guarantee that future governments would do the same.

Even so, some elements of fiscal policy could be hived off to technocrats. A fiscal council could monitor compliance with a budget-balance target, consistent with a stable or falling debt burden, leaving politicians to make tax and spending decisions within those limits. That sort of set-up has been adopted in Chile and Sweden.

Another convert is Hungary. George Kopits, the head of its fiscal council, says a good fiscal-stability framework has four main features. The first is a numerical policy rule, such as a target for the debt ratio or, as in Chile, a pledge to run a budget surplus of 1% of GDP over the business cycle. The second is a set of "procedural" rules, such as a cap on public-sector pay growth or—as in Hungary now and America until 2002—a "pay-go" rule that says new spending schemes have to be funded by tax increases or cuts in other programmes.

Monitoring by an independent and authoritative body, which is needed to keep governments honest, is the third element. This requires the fourth feature, full and clear public accounts that include all future costs, such as pensions. The ideal mix of these elements will vary with political cultures, says Mr Kopits. Brazil's bulky Fiscal Responsibility Act also governs regional public finances, where laxity has been a problem. Chile's rules are set with variable copper revenues in mind. Hungary has a rule that limits spending growth, the source of past indiscipline.

There is some evidence that countries with fiscal rules have sounder public finances, though it is tricky to separate cause from effect. Countries that have a culture of prudence are more likely to adopt rules. So are countries that have had fiscal crises. It is much harder to agree on restraints where the risk of fiscal collapse is distant. And rules imposed from outside, as with the euro zone's Stability and Growth Pact, are less likely to succeed.

The job of overhauling public finances is often hampered by politics. But it can be done. Some calculation lies behind proposals from Britain's main opposition party to adopt rules that would commit a Conservative government to running a balanced budget over the cycle and to reducing public debt as a share of GDP. The party plans to set up an Office of Budget Responsibility to act as a watchdog with teeth. There may be electoral appeal in that pledge if it reminds voters of the failings of the fiscal set-up put in place by Gordon Brown when he was finance minister.

In America worries about the dollar's international status and the appetite of Asian central banks for Treasury bonds may yet spur a consensus on the need for a binding fiscal framework. The rise in gold prices to above $1,000 an ounce this week reflects both fears for the dollar and concerns about the possible consequences for inflation of rising public debt.

What America needs is fiscal projections that say something about how and when deficits will be tamed, says Eric Leeper of Indiana University. That sort of detail would help taxpayers and bondholders to form views about future policy. As with monetary policy, fiscal policy works more effectively when people know what to expect, says Mr Leeper.

Adopting some medium-term constraints can even allow more freedom of action in slumps. For instance, Sweden's watchdog called in May for looser fiscal policy to support the economy.

Devising sound rules is tricky. There is no good theory on what is the right level of public debt. Then again, there is no robust research that says a 2% inflation rate is better than 4%, even if that is what many central banks aim for. Overly rigid rules may spur tighter policy in a slump, but allowing for the cycle can leave too much wriggle room, as Britain's fiscal mess shows. But even imperfect rules, if monitored well, are better than none at all.

The boss of CIT

Peek. Agh. Boo

Sep 10th 2009
From The Economist print edition

AP



Who better to extricate us from this mess than the man who led us into it? That is the curious logic at CIT, a small-business lender in America that is fighting to avoid bankruptcy. In a filing with the Securities & Exchange Commission on September 4th it emerged that CIT has given its boss, Jeffrey Peek, a sheepish pat on the back and a year’s contract extension to turn the firm round. Removing him in the midst of a restructuring effort would have brought some disruption, perhaps, but also fresh thinking. That would be no bad thing, given that Mr Peek’s big strategic move was an atrociously timed push into subprime mortgages and student loans, backed by flimsy wholesale funding. Rewarding such failure, even while taking away Mr Peek’s tax perks and use of corporate jets, merely adds to the firm’s list of blunders.

The G20 meetings

What next?

Sep 10th 2009
From The Economist print edition

Expect big talk on pay—and not much else—from the upcoming G20 meeting

Reuters



PITTSBURGH, the host of the next G20 summit on September 24th, is known as the "city of bridges". Anyone watching the build-up to the meeting may have already concluded that they will lead to nowhere. The warm-up event, a meeting of finance ministers and central bankers in London on September 4th, produced a fog of contradictory statements by multiple politicians, some from the same countries.

Depending on whom you listened to, capital requirements will get tougher quickly—or very gradually, to prevent banks shrinking their loan books. Bonuses will be governed by strict formulas—or by broad principles. Accounting rules will be made more forward-looking—or loosened to prevent big losses coming all at once.

Will Pittsburgh provide more clarity? The hard work ahead of the meeting has been outsourced to the Financial Stability Board, a club of regulators based in Basel. The most controversial issue is bonuses. Germany and France have demanded a tough line whereas Britain and America have been less keen on hard rules. Still, for all the grandstanding, a consensus does seem to exist. More will be paid out in shares rather than cash, and more pay will be deferred. How much, and how long for, are now the main bones of contention. An earlier plan to cap the percentage of profits banks can pay to staff looks like it is on the back burner. Some could still act unilaterally—the Netherlands has drawn up a code limiting bonuses for board members.

Capital is less exciting but more important. Everyone agrees on the destination: lots more pure equity, the highest-quality buffer against losses. But timing is a problem. Many banks in continental Europe have received "hybrid capital" from the state that does not count as pure equity (banks in America and Britain, by contrast, were forced to raise straight equity). A rapid rule-change would push them to start raising common stock from the state or private investors again. In Japan, too, banks have lots of preferred shares in their capital bases. Regulators there worry that Western supervisors are moving too fast. "It's dangerous," says one official. Rule-making "shouldn't be done in an environment of social anger."

Reforming capital is made far harder by the largely hidden but simmering row over accounting rules. Depending on how assets are valued on a balance-sheet, the amount of capital banks have today can vary enormously. Everyone says they want high-quality global standards, but they usually mean different things. American standard-setters prefer to mark assets to market, whereas continental European governments want to revert to "smoothed" balance-sheets, designed primarily for regulators rather than investors.

If it seems unlikely that the likes of Barack Obama and Silvio Berlusconi have passionate feelings on this, then at least there is an army of technicians beavering away on their behalf. The Basel committee of banking regulators has launched new proposals on both capital and liquidity. The various accounting bodies are trying to placate the politicians while avoiding watering down standards too much. The sheer

fiddliness of these reforms means they will take many months, even years, to be fully designed and implemented.

Does that mean Pittsburgh will be a damp squib? It may yet produce some fireworks on bonuses, but not on any of the deeper issues: a forced wave of equity-raising by European and Japanese firms is highly unlikely. In a sense that is a good thing. Reforming the financial system is complicated. And although banks need much more capital, there is no hurry while they are wrapped in state guarantees and the economy is fragile. Pittsburgh may even be exactly what is needed—loud talk, and the delegation to experts of the design of new and bigger sticks.

Buttonwood

Too big for its Gucci boots

Sep 10th 2009
From The Economist print edition

The causes of the overexpansion of the finance industry

Illustration by S. Kambayashi



IT MAY be a year since the fall of Lehman Brothers, but the main questions about the future of the finance industry have yet to be settled. Perhaps the biggest of the lot is whether the industry has become too big for the good of the economy.

Adair Turner, head of Britain's regulator, the Financial Services Authority, recently suggested another way of addressing this question by saying some banking activities were "socially useless". The phrase rightly implies that some of its operations are "socially useful". After all, a year ago, it was feared that if the banking system collapsed, the whole economy would break down.

Banks pool the capital of savers and lend it to companies at longer maturities, allowing them to invest in new factories and so on. They provide cash machines, debit cards and credit cards, enabling the vast majority of commercial transactions to take place. The finance industry provides liquidity to markets, thereby reducing the cost of capital. It allows companies to manage risks, such as sudden shifts in exchange rates, and thus enables more trade to take place than would otherwise occur. And the industry creates a market for corporate control, allowing capital to be moved from inefficient businesses to more efficient ones.

Most of these activities, of course, have been going on for decades, and in some cases centuries. So it seems doubtful that such activities suddenly became a lot more important in recent years. Yet between 1996 and 2007 the profits of finance companies in the S&P500 dramatically jumped from $65 billion to $232 billion, or from 19.5% to 27% of the total.

Other factors were probably at work. Paul Woolley, who set up the Centre for the Study of Capital Market Dysfunctionality at the London School of Economics, argues that this is a classic case of a principal-agent problem. The agents have better information than their clients—pension funds, retail investors and the rest—and the interests of the two groups are often not aligned. It can also be very difficult for clients to tell whether their many agents are doing a good job. A member of a pension fund relies on trustees to manage the scheme. Those trustees pick a consultant, who selects fund managers who might buy structured products from an investment bank. If those products include mortgage-backed securities, then lenders, brokers, property valuers and estate agents will also be involved.

Every agent takes a cut in the form of a spread or commission. But because financial products are complex or long-term in nature, the client may not realise the worst until it is too late. The finance sector is thus able to earn a high level of "rent" at the expense of its customers.

Why are these rents not competed away? Probably because products are not transparent. Consider fund management. This is an industry with few barriers to entry and no firm has a dominant market share. One would expect fees to be driven down remorselessly. In some areas, such as index-tracking, that does happen. But in the retail sector firms compete on the basis of past returns, not price. In the institutional sector fees for traditional fund management have dropped, but clients have been tempted into alternatives like hedge funds and private equity, where fees are much higher. Some financiers have become billionaires as a result.

In the case of banking, the implicit subsidy created by government guarantees (or the expectation of bail-outs in times of crisis) has reduced the cost of capital and thus increased returns.

The high level of rents extracted by the industry may have self-reinforcing aspects, too. The rents

translate into high salaries for employees, encouraging the brightest graduates to join the industry and devise more complex products to gain even higher rents (and to find new ways around regulations). The industry's profitability allows it to gain political influence, either through the funding of candidates or via the desire of governments to protect taxpaying businesses.

All this helps explain why finance grew too big for its boots, even if it is impossible to put a figure on the scale of its overexpansion. Government bail-outs have also prevented the industry from shrinking as much as it might have.

Such intervention means that it is now too late to insist on a purely free-market solution. And the scale of the rescue packages means that finance should pay some price. Governments cannot guess what the right size of the industry should be. But higher capital ratios would protect the taxpayer from future bank failures and limit the industry's profitability, while transparency might reduce the size of those rents.

Economist.com/blogs/buttonwood

Bankruptcy fees

Boom, bust, bonanza

Sep 10th 2009 | NEW YORK
From The Economist print edition

Court-awarded fees disadvantage creditors

AFP



EVEN the darkest cloud has a silver lining. Just ask the insolvency lawyers and other professionals who are raking in fees from the fast-growing number of large financial and corporate bankruptcies. None is doing better than Weil, Gotshal & Manges, the lead law firm in the clean-up at Lehman Brothers. It has requested more than $100m of fees in the case so far. Over half of that has already been approved by the presiding judge. In the four months to May, the most recent period billed for, Weil's lawyers worked 86,000 hours on Lehman, with the most senior partners getting around $1,000 per hour. They spent an estimated $692,000 on computer research and $224,000 on photocopies.

When all is done, lawyers, financial advisers, restructuring experts and others could bag close to $1 billion in court-awarded fees from Lehman, well above the $757m they received after Enron's demise, the record for a bankruptcy case. Their work is far from over. In August a British judge rejected a scheme that would have accelerated the winding-up of the failed investment bank's operations by dividing its creditors into three classes. Administrators of Lehman's London arm are considering litigation against its erstwhile parent.

It is frustratingly hard to say how much value for money these professionals provide. The judges who must approve their fees lack the time and expertise needed to review them properly. Just as importantly, judges in America have an incentive to go easy on fee requests. With bust companies allowed to choose which state they file in, forum-shopping is rampant. "Courts are well aware that one way to compete is by not messing with fees," says Lynn LoPucki, a professor at UCLA Law School.

So aggressive has this battle become that courts themselves appear prepared to bend or break the rules to win cases. A new study of 102 large-company bankruptcies between 1998 and 2007, by Mr LoPucki and Joseph Doherty, also of UCLA, finds that bankruptcy judges routinely authorise fee practices that violate America's bankruptcy code. These allow some fees to be paid before the court has even seen the request, for instance, and exempt some professionals from statutory disclosures.

The way to bring discipline to fees is to curb forum-shopping by insisting that firms only file in places where they have their headquarters or principal assets, argues Mr LoPucki. An alternative approach would be to force courts to make more use of services that audit lawyers' bills, such as Legal Cost Control and Legalbill. Their experts are trained to weed out excesses, such as billing for paralegal staff rather than cheaper clerks for menial tasks.

There are signs of pushback. In August, for instance, creditors of LandAmerica, a bust insurer, filed more than two dozen objections to the fee requests of the four law firms working on the case. The Obama administration is talking to fee-auditing firms about vetting bills incurred by its rescue programmes. Until courts tighten their scrutiny of fees, creditors have good reason to stay vigilant themselves.

Speculators and the oil price

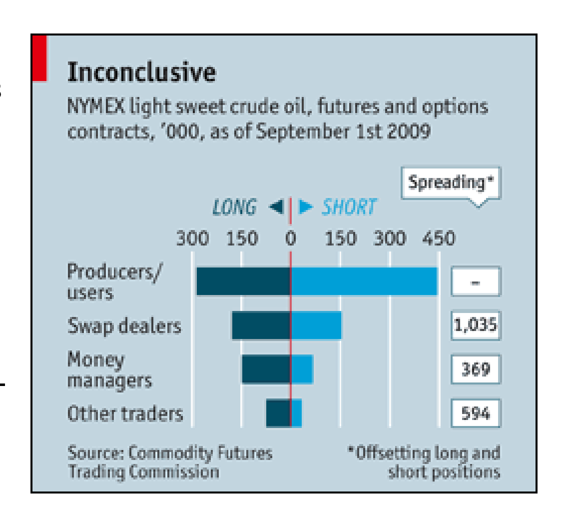
Data drilling

Sep 10th 2009 | NEW YORK
From The Economist print edition

The CFTC shines a little light on oil markets

BASHING "speculators" is a popular pastime for American politicians trying to explain high and volatile oil prices. But whether speculation has really been responsible for prices spiking is a controversial issue. In 2008 the Commodity Futures Trading Commission (CFTC) issued a report dismissing the role of speculators in last year's startling run-up in prices. But banks, hedge funds and others who bet on oil (without a use for the stuff itself) still face limits on the positions they can take, if Gary Gensler, the new CFTC head, can show that their influence in markets does harm.

On September 4th the CFTC added more evidence to the debate by releasing what it said were more transparent data on market positions. Before this month, the CFTC simply classified traders as "commercial" or "non-commercial" in its weekly report on the overall long and short positions in the market. Now it has started to disaggregate them further, into producers and users, swap dealers and "managed money". The third category includes hedge funds.



What do the new data show? Swap dealers and managed-money investors on NYMEX, the New York commodities exchange, were both long on oil as of September 1st—the latter by more than a 2-to-1 ratio (see chart). Producers and users, by contrast, were net short on oil. Swap dealers and managed-money players outnumber physical traders.

But analysts at Barclays Capital note that swap dealers still accounted for just 6.4% of total options and futures contracts, not enough to drive prices up on their own. Physical traders held more of the outstanding long positions (10.3%), and held even more short positions. This one set of numbers, in other words, does little to prove that speculators are overriding market fundamentals to influence prices. New quarterly data also released by the CFTC this month show that money flows to exchange-traded funds (ETFs) for commodities failed to correlate strongly with last year's price surge.

There are more disclosures to come. The CFTC says it will soon release disaggregated data going back three years. If those numbers, like the quarterly ETF data, are equally unconvincing on the role of speculation, the case for limiting positions will be weakened. And a strong counter-argument remains: that speculators provide crucial liquidity. Even if they also have some effect on prices, taking them out of the game could well do more harm than good. It is tempting to look for scapegoats when high prices hurt consumers. But the real culprits for oil-price volatility may be much more familiar: supply, demand and global instability.

Banco Santander in Brazil

Push the float out

Sep 10th 2009 | SÃO PAULO
From The Economist print edition

Spain's biggest bank offers shares in its Brazilian business

THE filing by Spain's Banco Santander on September 3rd to carry out an initial public offering (IPO) of shares in its Brazilian unit may seem plucky given rising default rates on bank loans. But an offering looks certain to succeed. The Brazilian economy is in decent shape: GDP growth should reach a healthy 4% in 2010, according to the latest survey of economists by the central bank. Appetite for Brazilian assets has been strong this year, VisaNet's 8.4 billion reais ($4.3 billion) offering in June being the most eye-catching example. And Santander's successful navigation of the financial crisis should also ensure hefty demand. The IPO, which is expected to take place this year, could raise as much as ten billion reais for a 15% stake, based on estimates of the unit's current market value.

Santander will spend the bulk of the money on an aggressive expansion of branches and ATMs in the richer south and south-east of the country, which accounts for some 75% of national output. That should help the bank consolidate its position in Brazil, where a judicious blend of acquisition and organic growth has given it a more Brazilian face than other foreign-owned banks. Santander bought Banespa, a São Paulo state bank, in 2000 and last year completed its acquisition of ABN AMRO's Brazilian business, making it the fourth-largest bank in the country. It has sensibly kept the services of Fabio Barbosa, who used to head ABN's Brazilian operations and is widely admired.

In the process Brazil has become more and more important for Santander, accounting for some 18% of global profits in the first half of this year. Mr Barbosa will focus his attention on Brazil's consumer-credit markets, which have historically been held back by swingeing interest rates and wide bank spreads but are now expanding rapidly. There's room for more growth: credit amounted to just 50% of GDP in Brazil in 2007, compared with 169% in America, according to the World Bank.

If Brazil's potential is not in doubt, Santander still faces plenty of difficulties. In the short term, defaults continue to rise: July marked the eighth consecutive month of increases. Santander Brazil has been hit by a rise in loans that are more than 90 days delinquent, from 5.4% in the first quarter to 6.9% in the second quarter, says Ceres Lisboa, an analyst at Moody's.

Competitors are on the march, too. In November Itaú and Unibanco, two of the country's largest private banks, announced a tie-up that catapulted the new entity to the number-one spot. An even bigger threat is state-controlled Banco do Brasil, which earlier this year snapped up a 49.99% share of Banco Votorantim, the country's seventh-largest bank by assets, as well as Nossa Caixa, another São Paulo state bank. In August the bank crowed that it had regained the top slot from Itaú-Unibanco. The Nossa Caixa deal in particular means it is now in a good position to turn its guns on Santander's heartland.

More active government policy to bring down fat spreads, in part through lenders such as Banco do Brasil, will also add to pressure on Santander's margins. Rosy though their prospects are, the Spaniards will not have things all their own way.

Patents as financial assets

Trolls demanding tolls

Sep 10th 2009 | NEW YORK
From The Economist print edition

Intellectual property comes of age as an alternative investment

Alamy



FOR those who got burned investing in bricks and mortar, it may be time for a punt on property of a more intellectual kind. Patents have traditionally been the domain of wild-haired inventors and computer geeks. These days they are just as likely to attract the interest of slick investors, from hedge funds and private-equity firms to venture capitalists and even distressed-debt funds. What was once viewed as a stodgy legal asset is fast becoming a sought-after financial one.

The market is still small but it is growing quickly—by perhaps 20-30% a year, reckons Coller Capital, an investment firm that has snapped up, among other prizes, IBM's portfolio of medical-device and health-care patents. Intellectual Ventures, based near Seattle, has spent a large chunk of the $5 billion it has raised from investors on buying patents; at the last count it had 27,000. Fortress, a big hedge-fund and private-equity group, is also active. Ron Epstein of iPotential, a patent-brokerage firm, says he is getting an ever-increasing volume of calls from hedge funds looking for patents related to mobile telecoms, medical equipment, biotechnology and the internet. He estimates that $4 billion-worth were bought and sold last year overall.

There are several kinds of seller. Some are inventors and universities that lack the resources to chase infringers or to develop their intellectual property (IP) while it still has value (patents expire 20 years after filing). Then there are distressed technology minnows, selling patents in the recession to raise the cash to survive. Administrators of bankrupt firms, alerted to the potential value of their charges' patents by the growth in trading, are increasingly looking to sell them. Another source of supply is large technology providers that are trying to manage their IP more actively. The majority of a typical firm's patents are of little or no use to its core businesses. Well-timed patent sales are also a way for public technology firms to meet quarterly profit targets, says Coller's Peter Holden.

Buyers also come in different shades, both industrial and financial. Of the financial ones, some hope to profit from the market's relative youth and illiquidity, seeking out undervalued patents and taking advantage of pricing inefficiencies (and the difficulty of valuing such a complex asset) to sell them at a hefty mark-up.

Others are longer-term holders, pejoratively referred to as "patent trolls", who are looking for an income stream from collecting royalties. Ugly they may be to those they harass, but lazy they are not. Such investors typically undertake exhaustive analysis of the relevant technologies and the firms that may be using them. Negotiations with those they deem to have breached a patent can be tortuous. Even by the standards of alternative investors, this is esoteric stuff. But the returns can be handsome and, with a broad enough portfolio, fairly predictable.

As the market evolves, its supporting infrastructure grows more sophisticated. New brokers are popping up. Like estate agents, they package together information—on the patent's validity, infringement by others and so on—and try to maximise proceeds for clients. iPotential has helped some clients get more than ten times the initial asking price. ICAP Ocean Tomo, another broker, began running patent auctions in 2006, and this year an affiliate set up an IP exchange. Its index of patent-rich shares is tracked by several exchange-traded funds. IP is moving out of the lab and into the financial mainstream.

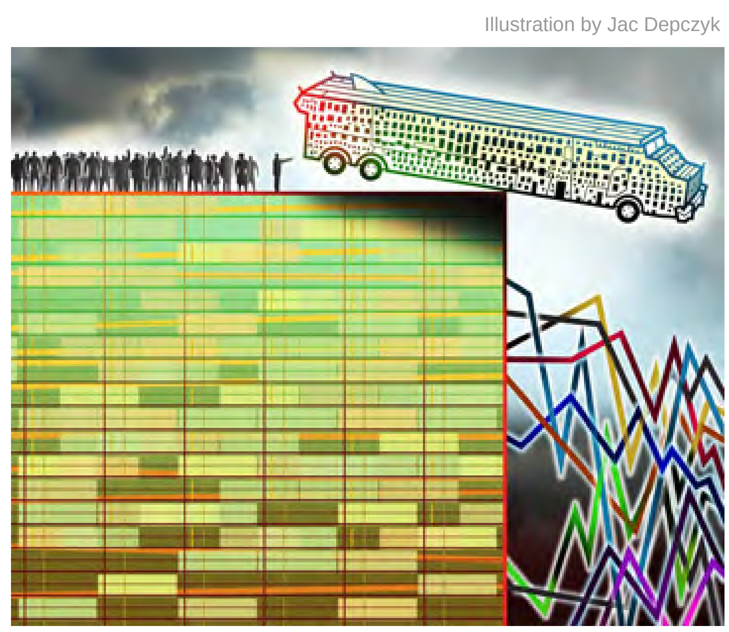
Economics focus

What if?

Sep 10th 2009
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If Lehman had not failed, would the crisis have happened anyway?

Illustration by Jac Depczyk



IN AUGUST 2008 Kenneth Rogoff, a Harvard University economist, briefly rocked world stockmarkets when he warned a conference in Singapore: "We're not just going to see midsized banks go under in the next few months, we're going to see a whopper, we're going to see a big one—one of the big investment banks or big banks." A month later, in the early hours of September 15th, Lehman Brothers filed for bankruptcy.

Harold James, an economic historian at Princeton University, says Lehman's failure was analogous to the collapse of Creditanstalt, a big Austrian bank, in 1931. Austria and Germany had borrowed heavily from foreign creditors and the bank's failure rippled around the world, vastly intensifying the Depression. Lehman's failure is widely seen as a similar turning-point in the current financial crisis: an unexpected blunder that came close to turning a garden-variety recession into another Depression.

Mr Rogoff has a different view. He believes, as he did the month before Lehman's collapse, that America had the classic preconditions of a massive financial crisis: trillions of dollars of debt secured by an inexorably deflating asset bubble. Bank write-downs already totalled more than $500 billion in August 2008. If Lehman had not been allowed to fail, some other firm would have, with similar results.

The week before Lehman failed, futures markets predicted a 15% decline in the prices of homes in major metropolitan markets in America over the next nine months, on top of the 24% decline that had already occurred. Such a drop—which is quite close to what actually occurred—would, when combined with similar declines in commercial-property values, have pushed some big banks to the edge. That same week derivatives markets put the odds of default for Washington Mutual, a large thrift (or savings bank), at 85%. Many of the big financial institutions that received bail-outs in the wake of Lehman's failure, such as American International Group (AIG) and UBS and Fortis in Europe, would probably have needed one sooner or later anyway.

True, from a purely economic point of view, Lehman's failure created enormous pain. It spawned a panic in the commercial-paper, credit-derivatives and bank-funding markets that dramatically worsened banks' liquidity. Capital and trade flows collapsed. A vicious spiral of credit withdrawal, weakening growth and debt impairment ensued. In July 2008 the IMF thought the world economy would grow by 3.9% in 2009. It now thinks it will shrink by 1.4%. Moody's Economy.com forecast in August 2008 that 2.9m first

mortgages in America would default in 2009, itself a disastrous figure (less than a million defaulted in 2006). It now expects the tally to hit 3.8m, a result, says Mark Zandi, its chief economist, of a string of policy errors and the resulting financial panic that sapped employment and income.

But from a political point of view, it is harder to see how these missteps could have been avoided. When the Treasury and the Federal Reserve bailed out Bear Stearns in March 2008, they drew criticism in Congress and elsewhere for creating moral hazard. At the same time their intervention led other firms, including Lehman, to believe that when push came to shove, they too would be spared. Had Lehman been rescued the criticism would have intensified, as would firms' expectations of future rescues. Mr Rogoff maintains that at some point political pressures would have required a big firm to go bust. "If you look at financial crises, the standard playbook is to let the fourth or fifth largest bank go under and you save everybody else," says Mr Rogoff, who bases much of his analysis on extensive research done with Carmen Reinhart of the University of Maryland for a forthcoming book called "This Time Is Different: Eight Centuries of Financial Folly" (see article).

Wise after the fact

In retrospect, the economically efficient solution would have been, soon after the Bear Stearns rescue, to propose a comprehensive, publicly financed recapitalisation of the banking system while creating a more orderly mechanism for winding up failed institutions (officials still claim they did not have the legal authority to save Lehman). The Treasury and the Fed drew up plans to do just that but worried that Congress would reject them. With good reason: history shows that bank bail-outs are intensely unpopular. Japan's government dragged its feet on recapitalising its banks in the 1990s because its initial aid provoked such outrage. Some American economists who used to carp at Japan's failings are more sympathetic now. "It is easier to be for more radical solutions when one lives thousands of miles away than when it is one's own country," Larry Summers, Barack Obama's economic adviser, told the *Financial Times* earlier this year.

If Mr Rogoff is right and more failures were inevitable, then Lehman's collapse, though painful, may have been necessary. History suggests that systemic banking crises are usually resolved with large injections of public capital. Lehman's failure galvanised policymakers. Only when faced with the post-Lehman, post-AIG chaos did Congress pass the $700 billion Troubled Asset Relief Programme (and even then, after an initial rejection). Other rich-country governments also moved to guarantee bank debts, raise deposit insurance and inject capital into their banks.

Mr James notes that when Creditanstalt went under in 1931, political tensions hampered international co-operation. The international response to Lehman's collapse, reflecting in part the lessons of the 1930s, was much more effective—as exemplified by the Treasury's willingness to bail out AIG, even though many of the main beneficiaries were European. Mr Rogoff concedes that if the Federal Reserve and Treasury had made flawless decisions unhindered by politics, the outcome would have been happier. But, he says, "it wasn't humanly possible." Lehman's collapse may even have hastened the ultimate resolution of the crisis.

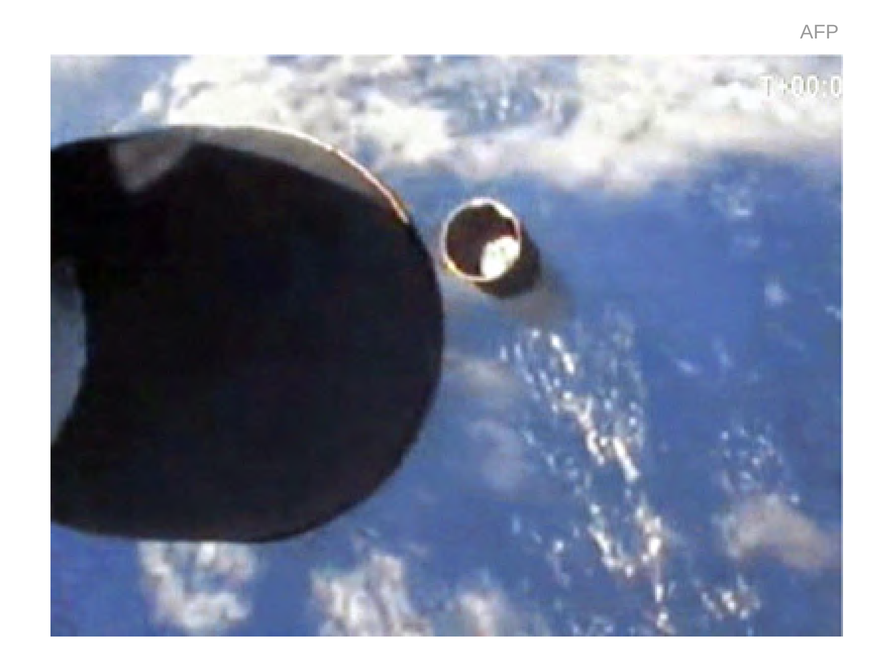
Space

Flying high

Sep 10th 2009
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America's government has no money for its human-spaceflight plans. The private sector has plenty

AFP



THE past, despite the disclaimer often found on advertisements for financial products, often can be a guide to the future. In the early days of flight, the American government awarded a series of guaranteed contracts for carrying airmail. This stimulated the growth of air travel to the point where passengers could be transported affordably and reliably, and was the root of airlines such as United and American. Those who wish to travel into space argue that the government should now be doing a similar thing for spaceflight, with its aerospace agency, NASA, playing the role of the post office. This week, there are signs that it might be about to.

At the behest of the president, NASA has been undergoing an independent review of its human-spaceflight plans. On September 8th the review committee delivered a summary report. That the agency does not have enough money to return to the moon is no surprise. What is more surprising is that the Augustine report (named after the committee's chairman, Norman Augustine) argues that NASA should stop travelling to the International Space Station in particular and to "low Earth orbit" in general. It should let the private sector do that instead, and focus its own efforts on more distant and difficult tasks.

Five years ago the idea that the private sector might have been capable of transporting cargo and people reliably into low Earth orbit was viewed as crazy. Much has happened since, and two things in particular. One was that Virgin Galactic, an upstart British firm, said it would develop a space-tourism business based around a craft that had cost only $25m to build. The other was that an equally upstart American entrepreneur called Elon Musk, flush from his sale of PayPal, created a company called SpaceX (whose Falcon rocket is pictured above, dropping its first stage on its way into orbit). He said he wanted to make it cheaper to launch people into space and wanted, ultimately, to send a mission to Mars—but that he would start by launching satellites.

We have lift-off

It would be an understatement to say that both ventures were treated with scepticism. But they have now come far enough to be able to thumb their noses at the cynics. On September 3rd SpaceX signed a

contract worth $50m with ORBCOMM, a satellite-communications firm. The deal is to launch 18 satellites for ORBCOMM's network. Meanwhile, at the end of July, Aabar Investments, a sovereign-wealth fund based in Abu Dhabi, bought a 32% stake in Virgin Galactic for $280m. Aabar was not just interested in space tourism. It was also keen on a proposal to use Virgin's White Knight launch system to put satellites into low Earth orbit. Will Whitehorn, Virgin Galactic's president, said that one of the things which attracted Aabar was the fact that White Knight (an aircraft which lifts to high altitude a rocket that can then take either passengers or satellites onwards into space) could be flown from Abu Dhabi.

Adam Baker of Surrey Satellite Technology, a British firm, knows a great deal about the economics of launching the kind of small satellites that Virgin's system might put into orbit. At the moment such satellites must either piggyback on the launch of a larger satellite or be launched rather expensively on their own rocket. A satellite costing only a few million dollars to build may thus cost $20m-30m to launch. Dr Baker says the challenge is to get the cost of a small-satellite launcher down to a few million, and he is so excited by the possibilities that he is leaving his employer to join Virgin Galactic.

Dr Baker reckons that costs can be cut if the launch rocket uses the satellite's guidance computer instead of having its own, and if the satellite's built-in rocket motor is bolstered to do the work now performed by a launch rocket's upper stage. That would mean satellite and launch rocket would have to be designed in tandem, so customers could not shop around for different launch vehicles. But Dr Baker is gambling that the system will be so cheap that this will not matter.

Over at SpaceX, developments have been just as interesting. Last year the company was given a $1.6 billion contract to send cargo to the space station. (Orbital Sciences, a firm that has been around since 1982, was awarded $1.9 billion to do the same.) This was the first time NASA had included private launch vehicles in its planning—the reality being that with the space shuttle about to retire the only other option was buying space on Russian rockets. The Augustine report now makes it more likely the government will dispense with NASA's services entirely in low Earth orbit and ask private firms to deliver crew to the station, as well as cargo.

Overall, the report is a healthy dose of reality for NASA. It warns that the agency's goals need to match its budget, and that it needs to internationalise its efforts, in order to make the most of its investments. For similar reasons the report tells NASA to extend the life of the space station. Abandoning the station in 2015, as is now the plan, would probably impair America's ability to lead international partnerships in the future. Spending a quarter of a century building something and then scuttling it looks bad, even if the useful science that has been done on board could be written up on the back of a postage stamp.

Finally, there is the moon. Should NASA go back? Mr Augustine's committee offers several possibilities. It does not rule out a return, but does describe something called a "Flexible Path" for exploration. This might involve sending people to the moon, but might also involve visiting asteroids and other places of interest. In other words, human exploration of the solar system does not have to be fixed doggedly on the moon first and Mars later.

Such flexibility sounds appealing. But in the case of NASA, which struggles to maintain funding for long-term projects because of short-term political juggling, it is a mixed blessing. If the committee's recommendations are implemented, the agency might still get much of what it wants, albeit more slowly than it would like. But there is a danger that without deadlines and an agreed budget, it will end up very rapidly going nowhere at all.

Tuna and pollock

A tale of two fisheries

Sep 10th 2009
From The Economist print edition

How to pillage the oceans deliberately, and by accident

Ardea



Food to sea lions. Fish fingers to people

THERE are two ways to overfish the sea. One is to ignore scientific advice and plunder on regardless. The other is to accept the advice, and then discover it isn't good enough.

For decades the Atlantic bluefin-tuna fishery has fallen into the former camp. The International Commission for the Conservation of Atlantic Tunas (ICCAT), the group charged with managing this fishery, has been a disgrace. Every year, its member states have handed themselves quotas far in excess of those prescribed by the organisation's scientific advice. Last year things were so bad that ICCAT's chairman warned members that if they did not do better their power to manage the bluefin would end up being taken away from them. But they failed to restrain themselves, and the backlash has begun. Earlier this year Monaco proposed that the bluefin be listed in Appendix I of CITES (the Convention on International Trade in Endangered Species of Wild Fauna and Flora). Such a listing would ban all international trade while the stock recovered.

Before such a suggestion can be put to a vote next March, a second member of CITES needs to support Monaco's proposal. This week, amid much internal political wrangling, the European Commission officially backed calls for a CITES listing. Since CITES is a convention on trade, the European Union's members, whom the commission represents, have to agree a common line on the matter, but a vote now seems much more likely.

Over in America, meanwhile, there are rumblings that the other type of overfishing, due to a flawed understanding of the science involved, is happening in Alaska's pollock fishery, one of the world's largest. Unlike the bluefin, the Alaskan pollock is among the most intensively managed fisheries in the world—it is run by America's National Marine Fisheries Service. Pollock are an important ingredient of fish fingers, fillets and many other products. Moreover, many people go out of their way to eat pollock in the belief that it is a sustainable choice of fish.

Last year's data suggested the population was low. However the Marine Stewardship Council, a London-based charity that certifies the fishery as sustainable through an independent auditor, said this was within the natural range of variation for the species, and that a recovery is expected this year. Not everyone is so sanguine. The latest data are not due out until September 18th, but Greenpeace, which has been arguing for almost a year that the fishery is on the verge of collapse, says it has had a tip-off that such a collapse is indeed under way.

If that is the case, Greenpeace says it will use America's Endangered Species Act to try to force the government to have the fishery closed. It is not that the pollock itself would be endangered at this stage,

but Steller’s sea lion, which the act covers, might be threatened if too much of its food were being eaten by people.

Self-erasing paper

Fade to red

Sep 10th 2009
From The Economist print edition

A way to write messages that will vanish spontaneously

INVISIBLE ink has a lengthy history. As early as the first century AD, Pliny the Elder wrote that the sap of a tithymalus plant could be used to render a message invisible to prying eyes. More recently, legions of schoolchildren have penned invisible messages using lemon juice. And to prove that even these days the stuff is not just a childish prank, part of the evidence that convicted Rangzieb Ahmed, an al-Qaeda operative in Britain, last year was that he had an address book with the telephone numbers of his confederates written in invisible ink.

What, though, of the opposite? Instead of something that starts off invisible and is then rendered legible (usually by the application of heat), how about a form of writing that is readable to begin with and then fades to invisibility? Such an ink, suggests Bartosz Grzybowski of Northwestern University in Evanston, Illinois, could have all sorts of applications, from the obvious one of expunging a sensitive message after a few hours, to bus and train tickets that expire automatically after, say, a month. Dr Grzybowski thinks he has managed to make such stuff.

Strictly speaking, his invention is not so much self-erasing ink as self-erasing paper. To create it, he and his team embedded particles of gold and silver into a gel made mainly of methyl methacrylate (the raw material of Perspex). This was sandwiched between two thin, plastic sheets. The metal particles, which were five nanometres (billionths of a metre) across, were themselves coated with a photosensitive compound called azobenzene. It was this that conferred the property of self-erasure.

When exposed to ultraviolet light, azobenzene molecules rearrange themselves internally, a process called isomerisation. The new isomers are much more electrically polarised than the original ones, which causes the particles they cover to attract each other, forming clumps. This, in turn, results in a change in the colour of the film, because that colour is determined by the sizes of the particles.

Nanoparticles of metal do not have the same colour as that metal does in bulk. Being smaller than the wavelength of light, they absorb light in a different way from a solid surface. The colour comes from the light that remains unabsorbed. Five-nanometre gold particles, for example, look red, and silver ones look yellow.

As the particles clump together, though, gold's red turns to blue and silver's yellow turns to violet. The upshot is that you can write on Dr Grzybowski's paper (using a pen that emits ultraviolet light) or print on it (using a patterned mask through which such light is shone). The isomerisation occurs in milliseconds, so normal writing speeds are possible.

The self-erasure happens because the new isomer of azobenzene is not as stable as the old one. The writing thus fades over the course of time—a process that can be hastened by strong light or heat. By tweaking the amount of clumping (changing the intensity and duration of ultraviolet-light exposure, as well as the number of nanoparticles embedded within the film), the spontaneous self-erasure time of the paper can be altered from hours to weeks. Also, since bright light undoes the clumping, the writing cannot be duplicated on a standard photocopier (though it can still be photographed, as long as no flash is used).

Though this is not the first time that self-erasing paper has been made (in 2006 Xerox demonstrated a light-sensitive paper that self-erased after 16-24 hours) Dr Grzybowski's method is more deployable. The writing can last longer, and the paper can be reused hundreds of times without loss of quality. Dr Grzybowski also claims his invention has a greater colour range (made possible by choosing different sized nanoparticles), which he hopes to extend still further by introducing particles made from other substances.

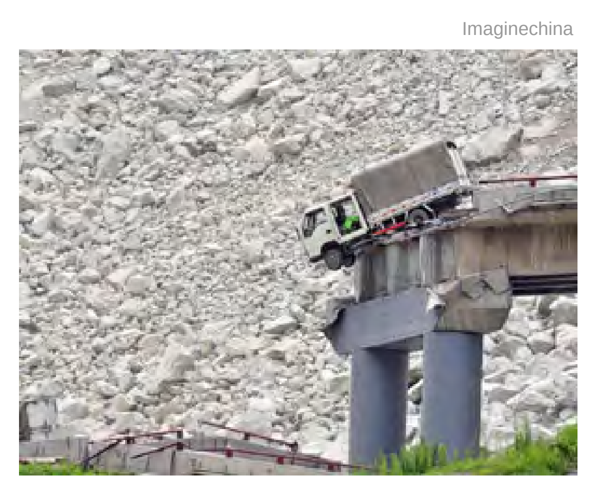
Earthquake-proof bridges

Beaten but not broken

Sep 10th 2009
From The Economist print edition

Engineers hope to keep bridges working after earthquakes

Imaginechina



Hang on lads, I've got a great idea

THERE are few safe places to ride out an earthquake. Surprisingly, though, a recently constructed bridge is often one of them. Engineers have become good at designing bridges that are earthquake-resistant enough to preserve the lives of those caught crossing when a quake strikes. The problem is that the bridge is often unusable afterwards. That can hamper the activity of emergency crews as they move around after a quake.

Mehdi Saiidi of the University of Nevada, in Reno, thinks he may have found a way to keep earthquake-damaged bridges working. He proposes to make the parts most likely to fail out of a substance called shape-memory alloy, which can "remember" what it is supposed to look like even after it has been twisted drastically out of kilter.

Dr Saiidi gained his crucial insight by jostling models of bridges on a specially built "shake table". He found that, rather than failing simultaneously, bridge components tend to break in a predictable order, and that the failure of one triggers the failure of the next. So, he reasoned, if the pieces that break first can be protected, the rest should never fail.

Aerospace and biomechanical engineers have long been aware of shape-memory alloys, but these materials have come to the attention of civil engineers only recently. Most solids, if pulled or twisted, will give a little in a process known as elastic deformation. Stop pulling and they will return to their original shape. Apply enough force, though, and you will go past what is known as the elastic limit and the object will be deformed permanently.

Dr Saiidi's nickel-titanium memory alloys, by contrast, are superelastic. They can be distorted about 20 times as much as the steel components they replace before they reach their elastic limits. They are expensive, but the shake table shows where they can best be deployed to keep costs down while keeping bridges up.

Besides replacing crucial steel supports with shape-memory alloys, Dr Saiidi also proposes to replace the concrete in the area around those metal components with what is known as an "engineered cementitious composite". This is a substance that is reinforced with short polymer fibres. These give it flexibility, so it does not crack as readily as ordinary cement. The result should be a bridge that can deform in an earthquake without snapping, but which returns, more or less, to its original shape when the quake is over. It may need replacing in the long run, but it should be sturdy enough for emergency use.

Lehman Brothers and the crisis

A year on

Sep 10th 2009
From The Economist print edition

Two books make a case for looking back before forging ahead

National Pictures



A Colossal Failure of Common Sense: The Inside Story of the Collapse of Lehman Brothers. By Lawrence G. McDonald and Patrick Robinson. *Crown Business; 368 pages; $27. Ebury Press; £7.99*. Buy from Amazon.com, Amazon.co.uk

This Time is Different: Eight Centuries of Financial Folly. By Carmen M. Reinhart and Kenneth Rogoff. *Princeton University Press; 496 pages; $35 and £19.95*. Buy from Amazon.com, Amazon.co.uk

ON JUNE 7th 2005 the then new global head of fixed-income trading at Lehman Brothers launched a devastating attack on America's housing market. It was "pumped up like an athlete on steroids", he said in an office meeting. Those muscles gave a "false impression of strength and in the end would not be sustained". Almost instantly America's housing bubble started to deflate.

On February 9th 2007 Lehman's global head of distressed trading publicly challenged the boss of its mortgage-securitisation business, predicting that the "domino effect" of the collapsing housing market would damage the banking sector. He gave warning that Lehman, with its trillions of dollars of debt and high exposure to mortgage-backed securities, was at risk. You don't know what you are talking about, replied the head of mortgage securitisation.

Both Lehman traders were right in their gloomy prophesies. Had they been heeded by the investment bank's bosses, perhaps Lehman could have been saved. But both quit, derided for their bearishness. They later returned in a last-ditch effort to rescue the ill-fated investment bank, after a coup weakened its chairman and chief executive, Richard Fuld, and ousted his longtime crony, Joe Gregory, the chief operating officer. But by then it was too late: Lehman Brothers filed for bankruptcy on September 15th last year, becoming the best known casualty of the financial crisis.

Many blame the sycophantic "court of King Richard" for Lehman's undoing. To feed his desire for ever bigger bonuses, Mr Fuld encouraged the use of borrowed money to take big bets on rising property prices. He did not help matters by riling Hank Paulson, the former boss of Goldman Sachs turned treasury secretary, at a private dinner in early 2008. Though Mr Paulson encouraged Lehman's boss to sell the firm, Mr Fuld came away with a different message. "[W]e have huge brand with [T]reasury," he swiftly wrote in a now famous memo. This smug disregard of what was more an order than advice perhaps

strengthened Mr Paulson’s resolve to let Lehman go bust—a decision that was to prove catastrophic within days as the entire financial system panicked.

That, at least, is how Lawrence McDonald tells it. The former Lehman trader’s inside account of the investment bank’s collapse, published earlier this summer (and newly in paperback in Britain), has been branded by Mr Fuld as “absolutely slanderous”, not least for its description of him bunkered in his huge office on the 31st floor of Lehman’s headquarters (“Well, I left my office, I left my office plenty,” he has countered). It would come as no surprise to learn that Mr McDonald (who wrote his account with Patrick Robinson) has taken some liberties in his highly readable yarn, which hits its stride a few chapters in. He provides no sources for scenes that take place after he was fired in early 2008, many of which show Mr Fuld in a particularly bad light. Yet “A Colossal Failure of Common Sense” largely rings true. It expresses the anger that many former Lehman employees still feel toward Mr Fuld. And it convincingly characterises the investment bank as a house divided against itself, between the bears who had foreseen bubbles and the bulls who wrongly believed that this time would be different.

The silly notion that history and precedent have no bearing on contemporary finance is at the root of what Carmen Reinhart and Kenneth Rogoff call “eight centuries of financial folly”. The two economists’ book is no page-turner (though it is much more readable than the academic research it draws from). But it is essential reading nonetheless, and is certain to have a longer shelf-life than the Lehman book, both for its originality and for the sobering patterns of financial behaviour it reveals.

The authors identify several red flags that indicate a looming financial crisis (such as house prices rising in tandem with increased debt-to-income ratios), many of which were visible in the run up to Lehman’s demise and the panic that followed. Even more worrying is their evidence of just how damaging banking crises tend to be, and how long it takes to recover from them. In the aftermath of the average crisis, asset prices fall sharply. Real housing prices fall on average by 36% over six years, equity prices by 56% over three-and-a-half years. Unemployment tends to rise by seven percentage points during the down phase of the cycle, which on average lasts four years. Government debt increases by 86%; GDP falls by over 9% on average, and typically takes ten years to return to what it was before the crisis. (When only post-war crises are considered, this changes to just over four years, though the current crisis is worse than any of them.)

Mrs Reinhart and Mr Rogoff do not expect a quick recovery this time. Nor do they expect their proposed reforms—which include creating a new global financial regulator and beefing up the IMF, where Mr Rogoff was once chief economist—to prevent future crises, though they could make them less frequent. As they say, “The persistent and recurrent nature of the ‘this-time-is-different’ syndrome is itself suggestive that we are not dealing with a challenge that can be overcome in a straightforward way.”

The problem lies in the human tendency to be optimistic and forget the lessons of the past. There will be other banking crises, so the world must learn what it can from this one. Lehman Brothers is dead; long live Lehman Brothers.

The Fed and the crisis

Financial firefighting

Sep 10th 2009
From The Economist print edition

In Fed We Trust: Ben Bernanke's War on the Great Panic. By David Wessel. *Crown Business; 323 pages; $26.99*. Buy from Amazon.com

CENTRAL bankers are not typically associated with high drama. But a year ago America's top economic policymakers faced a momentous decision: whether or not to let Lehman Brothers fail (see article).

Ever since, debate has raged about the effect of these decisions. Could Ben Bernanke, chairman of the Federal Reserve, and Hank Paulson, then treasury secretary, have saved Lehman? Was their failure to do so a colossal mistake, or would the financial crisis have deteriorated anyway? Analysts will debate these questions for years. As they do, this book should be at their side. David Wessel has written a gripping blow-by-blow account of how the top brass at the Federal Reserve and Treasury flailed against financial collapse.

He begins with a vivid description of the drama that played out at the New York Fed on the weekend of Lehman's collapse: the frantic search for a buyer for the beleaguered bank; the efforts to convince other Wall Street firms to chip in; the unwillingness to engage in a wholesale public bail-out; the hopes pinned on Barclays as a saviour, dashed, in his view, by Britain's Financial Services Authority; and the subsequent inevitability of bankruptcy. Mr Wessel lays out the chain of events that led both to Lehman's demise and to the policymakers' decision that they couldn't (or wouldn't) save it. He then describes the same officials' extraordinary efforts to combat the calamitous consequences. Along the way, he takes a useful look at the 1907 financial panic (which eventually prompted the creation of the Federal Reserve), and offers a quick recap of the underlying origins of the crisis (much blame is pinned on Alan Greenspan). But this book is largely a tick-tock tale of a battle by technocrats against an ever-changing crisis during 2007 and 2008.

The core cast is small. Along with Mr Paulson at the Treasury, four central bankers take centre stage. These "Four Musketeers", as they became known at the Fed, include Mr Bernanke at the helm, determined to do "whatever it takes" to avoid a repeat of the Depression; Don Kohn, the Fed's vice-chairman and longtime insider; Tim Geithner, then president of the New York Fed, now Barack Obama's treasury secretary; and Kevin Warsh, a whizz-kid former investment banker, who moved from George Bush's White House to become the youngest Fed governor in 2006.

The story of their financial firefighting is a thrilling one, deftly told by a veteran journalist with access to those involved. Mr Wessel has an eye for enlivening detail (a deal between the Feds and Subway restaurant, for instance, ensured a ready supply of sandwiches); and he has a knack for making finance accessible to the layman without boring the specialist.

This book is not a comprehensive account of the crisis: that would have required more time, more research and the inclusion of people other than the officials involved. Nor is it wholly impartial. Mr Wessel's assessment of Mr Geithner is a bit rose-tinted, while he overdoes the criticism of Mr Paulson as bungling and erratic. Nor does the book stand out analytically. Mr Wessel is broadly sympathetic to the officials' response. When he faults them for being slow to realise the gravity of the crisis, or for failing to prepare for the collapse of another big financial institution after the Bear Stearns bail-out, his criticisms are conventional and underdeveloped.

Mr Wessel spends little time teasing out lessons for crisis-management or for the future of central banking. But he has written a cracking story, the best chronicle so far of what officials were doing in the great financial bust of 2007-08.



Charles Dickens

An extravagant imagination

Sep 10th 2009
From The Economist print edition

Charles Dickens. By Michael Slater. *Yale University Press; 720 pages; $35 and £25*.
Buy from Amazon.com, Amazon.co.uk

Getty Images



An unfathomable mystery

OVER dinner once an American friend quizzed Charles Dickens about the workings of his imagination. Where on earth did those wonderful characters come from? "What an unfathomable mystery there is in it all!" replied the creator of Little Nell, Oliver Twist, Ebenezer Scrooge, Uriah Heep, Miss Havisham, Pip, Pickwick and the rest. Raising a wine glass, he continued: "Suppose I choose to call this a character, fancy it a man, endue it with certain qualities; and soon the fine filmy webs of thought, coming from every direction, we know not whence, spin and weave about it, until it assumes form and beauty, and becomes instinct with life."

Scholars have pondered this mystery for well over a century. Michael Slater's biography begins with two key events in Dickens's childhood: the imprisonment of his father for debt and the boy's own humiliating experience working in a boot-polish factory. More than 600 pages later the ageing Dickens, by now rich, famous and almost universally revered, is to be found hobnobbing with the queen, making genteel small talk about servants and "the cost of butchers' meat and bread".

In between came an enormous amount of hard work. From the time he published his first story in 1833 till his death in 1870, Dickens was frantically busy, not only with his writing but also with a crammed social diary and taxing commitments to charities, causes and campaigns. He was ruthlessly disciplined, versatile and prolific, and thrived on pressure. The attention Mr Slater gives to Dickens's less familiar writings—the short stories, journalism and essays—is one of the things that distinguish his excellent biography.

Dickens's family life was as emotionally charged as anything in his fiction. His marriage did not survive his introduction, in 1857, to Ellen Ternan, an actress. He was 45, she was 18. It remains unclear exactly what sort of affair they embarked on, but Dickens was sufficiently besotted to banish his wife of 22 years, Catherine, who had given him ten children. He spoke of her as a "page in my life" that had become "absolutely blank". Meanwhile he set Ellen up in love-nests in England and France, where he would visit her as often as possible. Having worked tirelessly to achieve a position of gentlemanly respectability, neither a divorce nor an open affair was an option. In the end the great love of his life may have been the one he shared with his adoring readers.

Mr Slater, a professor emeritus of Victorian literature at Birkbeck College, London, has probably forgotten more about Dickens than most people will ever know. The challenge of compressing such a rich and well-documented life within a single volume must have been immense.

Two things stand out. He is good at relating events in Dickens's life to his books. This is especially useful in his discussion of "David Copperfield", the most autobiographical of Dickens's novels (and his "favourite child"). He is good, too, on the composition of the major works. He reproduces snippets from Dickens's "mems", the terse notes that he used to keep track of his large casts of characters and multiple storylines. "Esther's love must be kept in view, to make the coming trial the greater and the victory the more meritorious"; "Jo? Yes. Kill him." That such jottings were all Dickens needed to keep the spaghetti-tangle of "Bleak House" straight in his head is astonishing. Still more astonishing is the fact that with some of his later novels, such as "Great Expectations", he saw the plot so clearly from the outset that he did not bother with notes of any kind.

Mr Slater has written an authoritative and engaging biography. Perhaps he might have done more to capture the sheer weirdness of Dickens's fictional world. The life is expertly described. But the fundamental mystery of what fired that unique and extravagant imagination remains, as Dickens told his American friend, unfathomable.

Seahorses

How odd, how lovely

Sep 10th 2009
From The Economist print edition

Poseidon's Steed: The Story of Seahorses, from Myth to Reality. By Helen Scales. *Gotham Books; 272 pages; $20. To be published in Britain by Gotham in November.* Buy from Amazon.com

Ardea



THE world's first public aquarium opened in May 1853. The brainchild of Philip Henry Gosse, an English naturalist, the London Fish House unveiled in 1859 four seahorses, long believed to be mythical creatures.

In a Victorian Britain obsessed with the natural world, these seahorses—with their equine heads, pouched torsos and curling tails—were an instant hit. It was as if they swam straight from the pages of a fairy-tale. Visitors were soon flocking to see them in aquariums all over Europe and America.

Although the Victorians started the craze for aquariums and seahorse-keeping that continues today, seahorses have fascinated mankind for millennia. Aboriginal paintings of "rainbow serpents" from 6,000 years ago bear striking similarities to seahorses. The Minoans portrayed them on jewellery, while the ancient Greeks had the "hippocampus" (half horse, half fish) pulling the chariots of Poseidon, the sea god.

In this fascinating book Helen Scales, an aptly named marine biologist, explains the myth, biology and ecology of what the Victorians called "queer fish". Indeed, the world's 37 species of seahorse are fish, breathing through gills and using a swim bladder to control their buoyancy. Sizes range from the pygmy seahorse (such as *Hippocampus denise*), which is smaller than a human fingernail, to the strapping "big-belly" seahorse (*Hippocampus abdominalis*), which can be nearly a foot (30 centimetres) long.

Placid and slow, seahorses do not flee from predators, but instead camouflage themselves, changing their skin colour to match their habitat. Anchoring themselves to blades of grass or fingers of coral with their tails, seahorses spend their time feeding on zooplankton; their gulp is among the fastest-known movements of all vertebrates. Most fascinating is that seahorses are the only species in which the males become pregnant, providing the young with food and oxygen before giving birth to up to 1,000 babies, each the size of a flea.

Ms Scales is clearly bowled over by her subjects. She recalls her first sighting of a wild seahorse as "like glimpsing a unicorn trotting through my garden". But despite mankind's professed love for these creatures, around 25m are plucked from the oceans every year, mostly to meet the demand for traditional Chinese medicines.

This threat to seahorse populations has prompted efforts to protect them. Six species have been labelled vulnerable to extinction by the International Union for Conservation of Nature, while the Convention on International Trade in Endangered Species began regulating the trade in seahorses in 2004. It is too early to gauge the effectiveness of these moves. But one thing is certain: it would be tragic if seahorses vanished from the oceans to become once more creatures of myth.

British reportage

Goodbye to all that

Sep 10th 2009
From The Economist print edition

The Country Formerly Known as Great Britain: Writings 1989-2009. By Ian Jack. *Jonathan Cape; 336 pages; £18.99*. Buy from Amazon.co.uk

THE crazy competitiveness of the British newspaper industry does not, alas, generate a commensurate quality of journalism. In general, the crowding of the market encourages shallow sensationalism, not consideration and depth. Ian Jack is a rare and shining exception to that rule.

“The Country Formerly Known as Great Britain” is a collection of his writing over the past 20 years, including newspaper columns and longer essays. His preoccupations include family, railways and the Indian subcontinent. He concentrates on “the special twists and peculiarities” of sometimes obscure places and people. He draws out links between private history and the public kind, following connections and intimating meanings.

A recurrent theme is the decline of an old, imperial, confident version of Britain, and in particular the industrial civilisations of northern England and Scotland in which Mr Jack spent his childhood and his forebears their lives. This was a land whose maps were marked with the goods each region produced—ships next to Newcastle, coal and wool for Yorkshire. There were trams, orderly queues, makeshift picture houses and smoking factory chimneys. The Sabbath was observed and sugar was an indulgence. India captivates Mr Jack because it preserves some vestiges of this dead civilisation in tropical aspic, “frozen in the Victorian economy of the lower Ganges”. Britain now is characterised by obscenity, reality television and adolescents whose sentences go up at the ends. It is “unsound” and “incompetent”.

Some readers may be sceptical of Mr Jack’s left-wing conservatism, and wonder whether the economic changes and “rootless wealth” he seems to lament did not bring some benefits alongside the dodgy privatisations and “slapdash new primitivism of shopping malls and car parks”. Indeed, by his own account, the vanished communities he chronicles were blighted by lethal epidemics and casual racism; home to backstreet abortions as well as civic pride.

But such a response misses Mr Jack’s point. This is not a political book (its subtlety is ill-served by its embittered title); it is elegiac rather than nostalgic. Its author emerges as a grittier W.G. Sebald, a lyrical German writer with the same forlorn urge to rescue lives and cultures from oblivion. Mr Jack’s real interests are time and memory: how a country’s past, or a person’s, gets cut off from the present; how history comes to feel “outside and apart”, bequeathing “a sense of baffling loss”.

At the heart of the book are three magnificent essays, about the Hatfield train crash of 2000; the sinking of the Titanic and the film “Titanic” (a wonderful meditation on hysteria and myth-making); and the lost cinemas of Farnworth, Mr Jack’s home town, which is also a circuitous epitaph for a lost brother. His contributions to “this unequal struggle to preserve and remember” cumulatively transcend journalism and attain the status of literature.

Skellig Michael

An Irish riddle wrapped in a mystery

Sep 10th 2009
From The Economist print edition

An unholy row may yet shed light on a unique Christian monument

An unholy row may yet shed light on a unique Christian monument

NEAR the top of a half-submerged mountain, jutting out of the Atlantic on the south-western tip of Ireland, stands a set of monastic remains that present historians with a puzzle. They are among the most revealing and the most elusive remnants of the early Christian era.

Heritage Dept. Dublin



The dramatic Peak

On one hand, the beehive-shaped stone huts where monks lived, prayed and worked are more intact than at any comparable site. They provide insights into the building and engineering skills as well as the religious practices of Ireland's Christian pioneers. On the other hand, much about the Skellig Michael site, including its age, remains enigmatic. References to it in written sources, the earliest in the late eighth century, are fleeting; only a handful of artefacts have been found.

But is the veil of mystery hanging over Skellig Michael, where excavation and conservation have been under way since 1978, even thicker than necessary? That is a debate raging among Ireland's archaeologists, and it is one in which UNESCO, the UN agency for cultural heritage, has become deeply involved.

UNESCO listed Skellig Michael as a "World Heritage Site" in 1996. Last year it published a report on the island that tried to settle the Irish argument. Its intervention was largely prompted by Michael Gibbons, an independent historian who had asserted that archaeological mistakes were being made there, and were being covered up by a conspiracy of silence.

Some of his criticisms concentrated on the well-known monastic enclosure, seen every year by tens of thousands of visitors who are ferried out by local boatmen and must then climb more than 600 steps. But Mr Gibbons's graver complaints concerned an even more remote place: an amazing set of structures perched on a ledge below the island's summit, in an area known as the South Peak.

Grellan Rourke, the conservationist who has overseen the island for three decades, passionately defends his labours at the South Peak. He says the works there—which have included shoring up a stone retaining wall and restoring an outdoor stone altar—were not only necessary, but a feat. "We worked with harnesses and climbing ropes and set up our plane table on the most incredible ledges with… sheer drops all around," he has written. "[B]ut the results were worth the efforts."

At issue is whether such acts of conservation threaten the site's integrity. Mr Gibbons argues that his compatriots are out of step with new archaeological thinking, which favours leaving structures untouched for future investigators. "I approached UNESCO with a heavy heart," he says, insisting that criticising fellow Irishmen was not a step taken lightly.

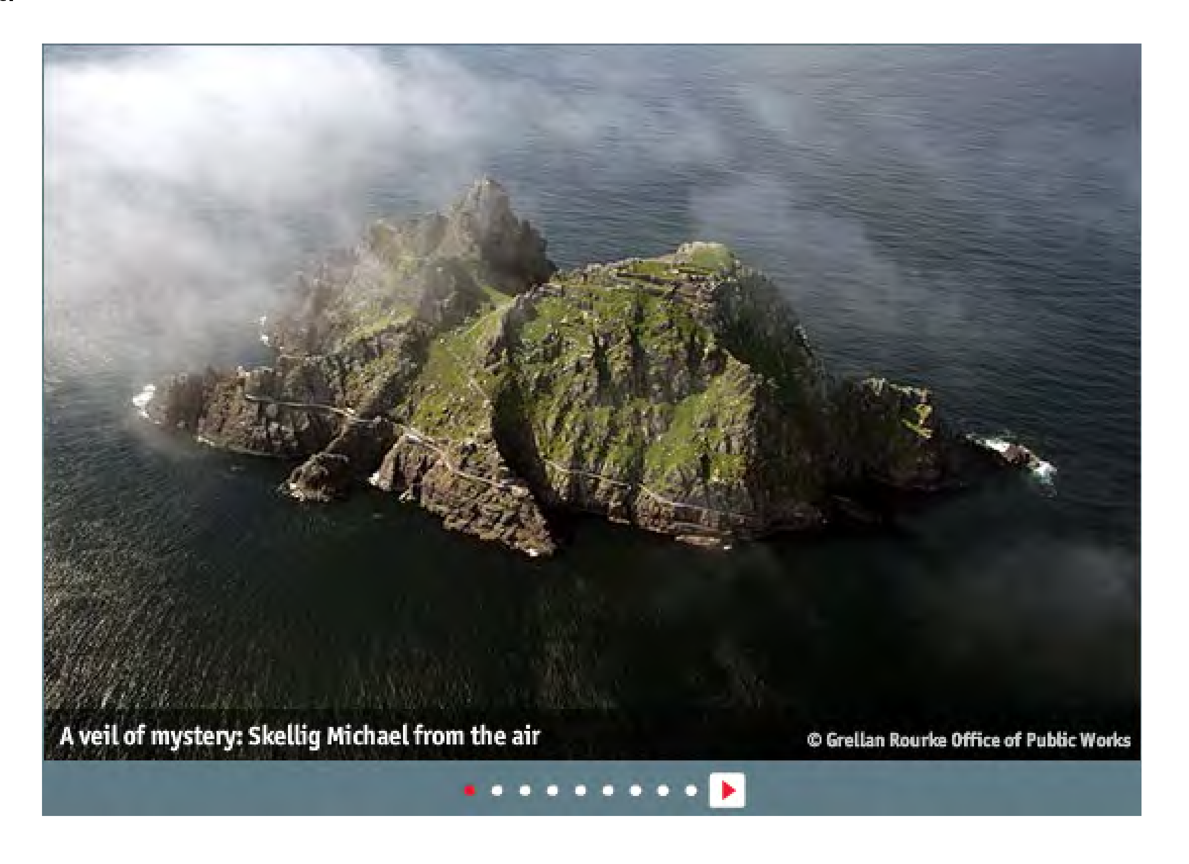
In a Solomonic judgment, UNESCO found that the structures on the South Peak—apparently an offshoot of the monastery, to which monks went for retreat or penance—had indeed been rendered "dramatically different". UNESCO said Ireland's Office of Public Works should have opened a broader debate before proceeding with any restoration; but it did agree that some conservation was necessary. The Irish government has followed some of UNESCO's recommendations, including naming a panel of independent Irish scholars to oversee the site.

This panel has given heart to Mr Gibbons, who says he has insights of his own that merit a hearing. For example, he recently discovered a new pilgrimage route across the island, which connects with two

existing ones. He has found a rare rock-hewn cross marking out the route.

History buffs are now waiting to see how Ireland's authorities act on yet another injunction from UNESCO: that vastly more should be published about the site, explaining what has been done and learned over 30 years. Mr Rourke and his assistant, Alan Hayden, are eager to give a full account of their labours. Mr Rourke says he will spend the next few winters writing up his early work at the monastic site, a time when walls were shored up and new evidence emerged that its structures have been at risk of collapse in every era of the island's history. Mr Hayden says he has around 4,000 photographs of the South Peak work, plus hours of film footage, which he will make available to the public as soon as resources allow.

Scholars are keen to hold the conservationists to this promise. UNESCO especially wants the distinction between new and old work at the peak to be made clear. And if the promised torrent of information about this mysterious island is duly delivered, then one Irish argument at least will have produced more light than heat.


A veil of mystery: Skellig Michael from the air

© Grellan Rourke Office of Public Works

Economist.com

PEOPLE
OBITUARY

Sergei Mikhalkov

Sep 10th 2009
From The Economist print edition

Sergei Mikhalkov, the Kremlin's court poet, died on August 27th, aged 96

AFP



TALENT without flexibility was a dangerous thing in the Soviet Union, as thousands found to their cost. Sergei Mikhalkov had talent aplenty, as a poet, playwright, children's writer and satirist. But, more important, he was flexible.

Mr Mikhalkov penned the words to two versions of the Soviet national anthem, one glorifying Stalin and one ignoring him. After Russia shrugged off communism he wrote a third version, to the same tune. In between he denounced two of the country's greatest writers, Boris Pasternak and Alexander Solzhenitsyn. Every regime he served gave him medals.

Servility towards power is a ubiquitous phenomenon. An 18th-century English song, "The Vicar of Bray", tells of a country clergyman who changed his allegiance with the times, Romish under James II, strongly Protestant under the Hanoverians, through every other point of the ecclesiological compass. The chorus runs:

> And this is Law I will maintain
> Until my Dying Day, Sir.
> That whatsoever King may reign,
> I will be the Vicar of Bray, Sir!

Mr Mikhalkov offered a Soviet version of the theme.

He was born in the Russian empire to a noble family, with admirals and princes among his forebears. Many of that breed fled from the Red Terror that followed the Bolshevik revolution; those that stayed behind had their lives blighted, or ended, by the communist hatred of "class enemies". But young Sergei slipped through that net, working humbly in a Moscow loom factory and writing poetry on the side. That was his ticket to the new aristocracy of proletarian cultural workers. He remained, at heart, a courtier and a cynic.

He gained his first success with a children's verse fable about the exploits of a very tall policeman, "Uncle

Steeple" (*Dyadya Styopa*). Given what the real-life police were doing in the Soviet Union in the 1930s, it should probably be classed as escapist fiction. A little later, he wrote a poem praising—he claimed—a girl with a dark-blond plait whom he had met at the House of Writers. Her name was Svetlana. Since that was also the name of Stalin's daughter, the poem brought the tall, tinny-voiced, stuttering young man to the dictator's notice.

In 1944 he was commissioned, along with Gabriel El-Registan, a Soviet Armenian poet, to write the words for a new national anthem to replace the "Internationale". The rousing hymn of the international workers' movement—freedom thundering against oppression, starvelings rising to end the age of cant—was felt not to fit the needs of the contemporary Soviet Union.

Its replacement, set to a stirring tune composed by Alexander Alexandrov, was a sentimental and militaristic ditty that gave equal weight to Lenin and Stalin:

> Through days dark and stormy where Great Lenin led us
> Our eyes saw the bright sun of freedom above
> and Stalin our Leader, with faith in the People,
> Inspired us to build up the land that we love.

Admittedly, national anthems rarely make great literature, and other Soviet poets, including on one occasion even the great Anna Akhmatova, found it expedient to put their pens at the service of the regime. But Mr Mikhalkov's loyalty was exceptional. A good example of his work is "I want to go home", a 1948 propaganda play about post-war orphanages in Germany, in which sinister British officials try to brainwash and kidnap Soviet children to use them as spies and slaves in the imperialist cause. The plot is foiled by heroic and kindly Soviet officers. The truth was exactly the other way round: it was the Soviet secret police who organised ruthless repatriations, often dividing families.

Songs without words

Mr Mikhalkov's lyrics did not long survive Stalin's death in 1953. From then until 1977 the anthem was played without words, neatly illustrating the Soviet Union's ambiguous attitude to Stalinism. Mr Mikhalkov adapted to the times, becoming a pillar of the Soviet literary establishment and a notable enforcer of party discipline in its ranks. He wrote, in 1970, some new lyrics to the national anthem. To mark the introduction of the new Soviet constitution in 1977, the authorities adopted them. They ignored Stalin, praised Lenin and highlighted Russia's role in welding the "unbreakable union of free-born republics".

The union proved anything but. Given a whiff of freedom under Mikhail Gorbachev, the captive nations of the Soviet empire bolted for the exit. They found, or restored, their own songs. But Russia was tongue-tied. It dumped the Soviet anthem and adopted a resonant tune by Glinka, called simply "Patriotic Song". It failed to catch on. In 2001 Vladimir Putin ordered the restoration of the Soviet tune—and it was Mr Mikhalkov's turn to write, once again, the words. The anodyne doggerel that resulted is no better (and certainly no worse) than other countries' national anthems. It praises Russia's uniqueness, mentions God, and concludes: "Thus it was, is, and always shall be!" Except that it isn't, and wasn't. Few knew that better than the wily Mr Mikhalkov.

Overview

Sep 10th 2009
From The Economist print edition

The number of unemployed in **America** rose by 466,000 in August, pushing the unemployment rate up from 9.4% to 9.7%. There were 7.4m more Americans out of work last month than were jobless in December 2007, when the country slid into recession. American firms, excluding farms, shed 216,000 workers from their payrolls in August, the smallest decline in a year.

A composite index of **Japanese** economic activity, including measures of manufacturing output and retail sales, rose in July to its highest level since December 2008. The increase was the fourth in as many months.

Unemployment in **Australia** was unchanged at 5.8% in August.

Britain's **industrial production** rose by 0.6% in July, led by a surge in car output. Germany's industrial output fell by 0.9%, following a rise of 0.8% in June, revised up from a previous estimate. In Sweden industrial production declined by 0.5%, leaving it almost 20% lower than a year earlier.

Switzerland's unemployment rate rose to 4% in August, its highest level since 1998.

The annual rate of consumer-price inflation in **Mexico** fell from 5.4% to 5.1% in August.

Analysts are cheerier about the outlook for GDP growth in 2010 for all the economies covered in our **monthly poll of forecasters** (see table). Britain is the only economy for which the average 2009 GDP growth forecast is lower than last month.

Output, prices and jobs

Sep 10th 2009
From The Economist print edition

Output, prices and jobs

% change on year ago

	Gross domestic product				Industrial production	Consumer prices			Unemployment
	latest	qtr*	2009†	2010†	latest	latest	year ago	2009†	rate‡, %
United States	−3.9 Q2	−1.0	−2.6	+2.5	−13.1 Jul	−2.1 Jul	+5.6	−0.4	9.7 Aug
Japan	−6.4 Q2	+3.7	−5.5	+1.4	−22.9 Jul	−2.2 Jul	+2.3	−1.1	5.7 Jul
China	+7.9 Q2	na	+8.1	+8.5	+10.8 Jul	−1.8 Jul	+6.3	−0.8	9.0 2008
Britain	−5.5 Q2	−2.6	−4.3	+1.1	−9.3 Jul	+1.8 Jul§	+4.4	+1.7	7.8 May††
Canada	−3.2 Q2	−3.4	−2.2	+2.1	−12.7 Jun	−0.9 Jul	+3.4	+0.6	8.7 Aug
Euro area	−4.7 Q2	−0.5	−3.9	+1.2	−17.0 Jun	−0.2 Aug	+3.8	+0.4	9.5 Jul
Austria	−4.4 Q2	−1.7	−2.9	+0.6	−11.4 Jun	−0.2 Jul	+3.8	+0.4	4.4 Jul
Belgium	−3.7 Q2	−1.1	−3.3	+0.7	−13.4 Jun	−0.8 Aug	+5.4	+0.3	12.3 Jul‡‡
France	−2.6 Q2	+1.4	−2.1	+1.5	−13.0 Jul	−0.7 Jul	+3.6	+0.2	9.8 Jul
Germany	−5.9 Q2	+1.3	−5.0	+1.6	−16.9 Jul	nil Aug	+3.1	+0.2	8.3 Aug
Greece	−0.3 Q2	+1.0	−3.5	−0.8	−9.2 Jul	+0.8 Aug	+4.7	+0.5	8.5 May
Italy	−6.0 Q2	−1.9	−4.9	+0.7	−21.9 Jun	+0.2 Aug	+4.1	+0.8	7.3 Q1
Netherlands	−5.1 Q2	−3.4	−4.1	+1.0	−12.7 Jun	+0.3 Aug	+3.2	+1.3	4.8 Jul††
Spain	−4.2 Q2	−4.2	−3.8	−0.5	−16.7 Jul	−1.4 Jul	+5.3	−0.3	18.5 Jul
Czech Republic	−4.9 Q2	+1.2	−3.5	+1.2	−12.2 Jun	+0.2 Aug	+6.5	+1.5	8.5 nil
Denmark	−4.1 Q1	−4.2	−3.8	+0.7	−14.3 Jul	+1.1 Aug	+4.3	+1.1	3.7 Jul
Hungary	−7.6 Q2	−8.1	−6.3	−1.0	−19.4 Jul	+5.1 Jul	+6.7	+4.3	9.7 Jul††
Norway	−4.8 Q2	−5.0	−2.0	+0.5	−8.0 Jul	+1.9 Aug	+4.5	+2.5	3.0 Jun§§
Poland	+1.1 Q2	na	−0.8	+1.5	−4.6 Jul	+3.6 Jul	+4.8	+3.2	10.8 Jul‡‡
Russia	−10.9 Q2	na	−7.0	+2.5	−10.8 Jul	+11.6 Aug	+15.0	+12.1	8.3 Jul‡‡
Sweden	−6.2 Q2	−0.1	−4.8	+1.7	−19.9 Jul	−0.8 Aug	+4.3	−0.2	7.9 Jul‡‡
Switzerland	−2.0 Q2	−1.0	−2.1	+0.7	−9.4 Q1	−0.8 Aug	+2.9	−0.5	4.0 Aug
Turkey	−7.0 Q2	na	−5.6	+2.3	−9.2 Jul	+5.3 Aug	+11.8	+6.2	13.6 May‡‡
Australia	+0.6 Q2	+2.5	+0.5	+2.0	−3.8 Q2	+1.5 Q2	+4.5	+1.6	5.8 Aug
Hong Kong	−3.8 Q2	+13.9	−5.4	+2.6	−10.2 Q1	−1.5 Jul	+6.3	nil	5.4 Jul††
India	+6.1 Q2	na	+5.5	+6.3	+7.0 Jul	+11.9 Jul	+8.3	+6.0	6.8 2008
Indonesia	+4.0 Q2	na	+4.1	+4.4	+0.2 Jun	+2.8 Aug	+11.8	+4.4	8.1 Feb
Malaysia	−3.9 Q2	na	−5.0	+3.3	−9.6 Jun	−2.4 Jul	+8.5	−0.3	4.0 Q1
Pakistan	+2.0 2009**	na	+3.7	+2.7	−4.4 Jun	+10.7 Aug	+25.3	+13.0	5.2 2008
Singapore	−3.5 Q2	+20.7	−6.2	+3.2	+12.4 Jul	−0.5 Jul	+6.5	−0.2	3.3 Q2
South Korea	−2.5 Q2	+9.7	−1.8	+2.0	+0.7 Jul	+2.2 Aug	+5.6	+2.6	3.8 Jul
Taiwan	−7.5 Q2	na	−5.7	+2.5	−8.1 Jul	−0.8 Aug	+4.7	−1.3	6.0 Jul
Thailand	−4.9 Q2	+9.6	−4.5	+2.1	−7.3 Jul	−1.0 Aug	+6.5	−1.0	2.4 May
Argentina	+2.0 Q1	+0.2	−3.5	+0.5	−9.0 Jul	+5.5 Jul	+9.1	+6.2	8.8 Q2‡‡
Brazil	−1.8 Q1	−3.3	−1.0	+2.7	−9.9 Jul	+4.5 Jul	+6.4	+4.9	8.0 Jul‡‡
Chile	−4.5 Q2	−1.4	−1.2	+3.0	−7.4 Jul	−1.0 Aug	+9.3	+1.9	10.8 Jul††‡‡
Colombia	−0.6 Q1	+0.9	−1.0	+2.5	−6.6 Jun	+3.1 Aug	+7.9	+4.6	12.6 Jul‡‡
Mexico	−10.3 Q2	−4.4	−7.1	+2.8	−10.6 Jun	+5.1 Aug	+5.6	+5.4	6.1 Jul‡‡
Venezuela	−2.4 Q2	na	−4.2	−2.7	+11.4 Mar	+28.8 Aug	+34.5	+26.6	7.7 Q2‡‡
Egypt	+4.2 Q1	na	+4.5	+3.9	+5.8 Q1	+9.0 Aug	+23.7	+9.8	9.4 Q2‡‡
Israel	+0.1 Q2	+1.0	−1.1	+1.5	−8.6 Jun	+3.5 Jul	+4.8	+3.1	8.0 Q2
Saudi Arabia	+4.5 2008	na	−1.0	+3.3	na	+4.2 Jul	+11.1	+4.3	na
South Africa	−2.8 Q2	−3.0	−2.2	+3.1	−17.1 Jun	+6.7 Jul	+13.4	+7.1	23.6 Jun‡‡
MORE COUNTRIES Data for the countries below are not provided in printed editions of *The Economist*									
Estonia	−16.1 Q2	na	−13.0	−3.0	−27.8 Jul	−0.9 Aug	+11.0	−0.8	17.0 Jun
Finland	−8.9 Q1	−10.0	−5.4	+0.4	−24.0 Jul	−0.6 Jul	+4.3	nil	8.9 Jul
Iceland	−6.5 Q2	−7.8	−6.5	+0.4	+10.1 2008	+10.9 Aug	+14.5	+12.5	8.0 Jul‡‡
Ireland	−8.5 Q1	−5.7	−7.7	−2.6	+2.6 Jun	−5.9 Jul	+4.4	−3.6	12.2 Jul
Latvia	−18.7 Q2	nil	−17.0	−4.0	−17.7 Jul	+1.8 Aug	+15.7	+3.0	17.2 Jun
Lithuania	−22.4 Q2	−40.8	−15.0	−4.5	−15.7 Jul	+2.6 Aug	+11.9	+4.6	9.7 Jul‡‡
Luxembourg	−5.5 Q1	−5.9	−4.9	−0.8	−14.7 Jun	−0.7 Jul	+4.9	+0.5	5.5 Jul‡‡
New Zealand	−2.2 Q1	−2.7	−2.1	+1.2	−11.4 Q1	+1.9 Q2	+4.0	+1.8	6.0 Q2
Peru	−2.1 Jun	na	+1.3	+2.7	−12.2 Jun	+1.9 Aug	+6.3	+3.5	7.9 Jul‡‡
Philippines	+1.2 Q2	+9.8	−1.0	+3.7	−10.8 Jun	+0.1 Aug	+12.4	+2.9	7.5 Q2‡‡
Portugal	−3.7 Q2	+1.4	−4.1	−0.4	−9.0 Jul	−1.5 Jul	+3.1	−0.7	9.1 Q2‡‡
Slovakia	−5.3 Q2	na	−5.5	+0.7	−21.6 Jul	+1.3 Aug	+5.0	+1.8	12.1 Jul‡‡
Slovenia	−9.3 Q2	nil	−6.0	nil	−22.3 Jun	nil Aug	+6.0	+1.1	9.1 Jun‡‡
Ukraine	−20.3 Q1	na	−17.0	+1.0	−26.7 Jul	+15.3 Aug	+26.0	+16.0	2.2 Jul
Vietnam	+4.5 Q2	na	+4.2	+4.8	+5.6 Aug	+2.0 Aug	+28.3	+6.8	4.6 2007

*% change on previous quarter, annual rate. †The Economist poll or Economist Intelligence Unit estimate/forecast. ‡National definitions. §RPI inflation rate -1.4 in July. **Year ending June. ††Latest three months. ‡‡Not seasonally adjusted. §§Centred 3-month average

Sources: National statistics offices and central banks; Thomson Reuters; Centre for Monitoring Indian Economy; OECD; ECB

The Economist commodity-price index

Sep 10th 2009
From The Economist print edition

***The Economist* commodity-price index**
2000=100

	Sep 1st	Sep 8th*	% change on one month	% change on one year
Dollar index				
All items	191.3	192.3	-3.2	-15.1
Food	196.4	193.1	-6.9	-16.3
Industrials				
All	184.6	191.2	+2.2	-13.6
Nfa†	145.4	148.0	+1.0	-20.6
Metals	206.0	214.9	+2.7	-10.6
Sterling index				
All items	178.7	176.0	-3.6	-9.6
Euro index				
All items	123.7	122.5	-5.7	-17.4
Gold				
$ per oz	951.15	995.85	+5.5	+22.8
West Texas Intermediate				
$ per barrel	68.26	71.22	+2.7	-30.4

*Provisional †Non-food agriculturals.

The Economist poll of forecasters, September averages

Sep 10th 2009
From The Economist print edition

***The Economist* poll of forecasters, September averages** (previous month's, if changed)

	Real GDP, % change: Low/high range		Real GDP, % change: average		Consumer prices % increase		Current account % of GDP	
	2009	2010	2009	2010	2009	2010	2009	2010
Australia	-0.2/0.8	0.8/2.8	0.5 (0.0)	2.0 (1.8)	1.6 (1.7)	2.2 (2.3)	-4.0	-4.4 (-4.5)
Belgium	-4.4/-3.0	-0.6/1.4	-3.3 (-3.5)	0.7 (0.4)	0.3	1.0 (1.2)	-2.2 (-2.4)	-2.0 (-2.5)
Britain	-4.6/-3.4	-0.5/2.1	-4.3 (-4.2)	1.1 (1.0)	1.7 (1.8)	1.9	-1.8 (-1.7)	-1.5 (-1.4)
Canada	-2.6/-1.6	0.7/2.8	-2.2	2.1 (1.8)	0.6 (0.5)	1.7 (1.8)	-2.1 (-2.3)	-1.4 (-1.6)
France	-2.3/-1.9	0.7/2.7	-2.1 (-2.8)	1.5 (0.8)	0.2	0.9	-2.2 (-2.1)	-2.1
Germany	-5.3/-4.6	-0.5/3.6	-5.0 (-5.9)	1.6 (0.8)	0.2	0.7 (0.8)	4.0 (3.7)	4.6 (4.1)
Italy	-5.2/-4.6	-0.3/1.7	-4.9 (-5.1)	0.7 (0.4)	0.8	1.3	-2.5 (-2.8)	-1.5 (-2.8)
Japan	-6.2/-5.1	0.7/2.3	-5.5 (-6.4)	1.4 (1.1)	-1.1	-0.6	2.7 (2.5)	3.1 (2.7)
Netherlands	-4.6/-3.9	-0.4/1.7	-4.1 (-4.3)	1.0 (0.7)	1.3	0.7 (0.9)	6.2 (6.1)	5.5 (5.3)
Spain	-4.2/-3.5	-1.0/0.5	-3.8 (-3.9)	-0.5 (-0.6)	-0.3 (-0.4)	1.2 (1.1)	-6.7 (-7.1)	-5.8
Sweden	-5.2/-4.3	0.3/3.1	-4.8 (-4.9)	1.7 (1.3)	-0.2	1.1 (1.2)	6.8 (6.7)	7.0
Switzerland	-3.5/-1.3	-0.3/2.2	-2.1 (-2.3)	0.7 (0.4)	-0.5	0.4	6.8 (7.4)	7.4 (8.0)
United States	-2.7/-2.4	1.5/3.2	-2.6	2.5 (2.0)	-0.4 (-0.3)	1.5 (1.3)	-2.9 (-3.0)	-3.0 (-3.1)
Euro area	-4.3/-3.6	-0.3/2.7	-3.9 (-4.4)	1.2 (0.6)	0.4 (0.5)	1.2 (1.1)	-0.9 (-1.3)	-0.5 (-0.7)

Sources: BNP Paribas, Citigroup, Decision Economics, Deutsche Bank, Economist Intelligence Unit, Goldman Sachs, HSBC Securities, KBC Bank, JPMorgan Chase, Morgan Stanley, RBS, Scotiabank, UBS

Trade, exchange rates, budget balances and interest rates

Sep 10th 2009
From The Economist print edition

Trade, exchange rates, budget balances and interest rates

	Trade balance* latest 12 months, $bn	Current-account balance latest 12 months, $bn	Current-account balance % of GDP 2009†	Currency units, per $ Sep 9th	Currency units, per $ year ago	Budget balance % of GDP 2009†	Interest rates, % 3-month latest	Interest rates, % 10-year gov't bonds, latest
United States	−639.5 Jun	−628.3 Q1	−2.9	–	–	−13.5	0.17	3.48
Japan	+9.0 Jun	+114.0 Jul	+2.7	91.8	108	−7.4	0.40	1.30
China	+269.4 Jul	+364.4 Q2	+6.1	6.83	6.84	−4.2	1.74	3.65
Britain	−135.2 Jul	−52.5 Q1	−1.8	0.60	0.57	−14.4	0.65	3.86
Canada	+15.5 Jun	−19.1 Q2	−2.1	1.08	1.07	−2.4	0.21	3.42
Euro area	−40.1 Jun	−157.5 Jun	−0.9	0.69	0.71	−6.5	0.78	3.32
Austria	−5.5 May	+10.7 Q1	+1.3	0.69	0.71	−5.6	0.78	3.81
Belgium	+6.3 May	−11.8 Mar	−2.2	0.69	0.71	−5.9	0.79	3.80
France	−65.3 Jul	−58.3 Jun	−2.2	0.69	0.71	−8.2	0.78	3.66
Germany	+179.4 Jul	+159.9 Jun	+4.0	0.69	0.71	−4.7	0.78	3.35
Greece	−50.6 Jun	−41.6 Jun	−8.5	0.69	0.71	−6.8	0.78	4.68
Italy	−11.2 Jun	−62.8 Jun	−2.5	0.69	0.71	−5.4	0.78	4.16
Netherlands	+43.5 Jun	+50.0 Q1	+6.2	0.69	0.71	−4.2	0.78	3.67
Spain	−92.5 Jun	−109.6 Jun	−6.7	0.69	0.71	−10.3	0.78	3.93
Czech Republic	+4.4 Jul	−4.7 Jun	−1.5	17.4	17.5	−4.8	1.84	5.06
Denmark	+8.2 Jul	+8.8 Jul	+0.9	5.10	5.31	−2.5	1.83	3.75
Hungary	+3.3 Jul	−11.3 Q1	−2.9	186	170	−4.3	7.93	8.06
Norway	+58.0 Jul	+69.5 Q2	+14.6	5.89	5.73	7.1	1.97	4.19
Poland	−13.5 Jun	−11.7 Jun	−0.5	2.82	2.42	−3.7	4.18	6.20
Russia	+112.5 Jul	+55.3 Q2	+1.9	31.0	25.7	−8.0	10.75	10.87
Sweden	+12.9 Jul	+29.0 Q2	+6.8	7.00	6.77	−4.4	0.17	3.41
Switzerland	+15.8 Jul	+56.6 Q1	+6.8	1.04	1.13	−1.3	0.31	2.11
Turkey	−42.9 Jul	−20.3 Jun	−0.4	1.49	1.24	−5.8	8.21	5.99‡
Australia	+5.3 Jul	−29.0 Q2	−4.0	1.16	1.24	−3.9	3.44	5.39
Hong Kong	−21.0 Jul	+29.6 Q1	+11.4	7.75	7.80	−3.8	0.20	2.20
India	−87.4 Jul	−29.8 Q1	−1.1	48.5	45.1	−8.0	3.39	7.67
Indonesia	+12.5 Jul	+4.4 Q2	+1.2	9,925	9,330	−2.8	6.99	6.29‡
Malaysia	+35.9 Jul	+40.5 Q1	+14.1	3.50	3.46	−8.0	2.14	2.02‡
Pakistan	−16.3 Jul	−12.2 Q1	−3.2	83.0	76.6	−4.3	12.55	10.71‡
Singapore	+18.4 Jul	+21.4 Q2	+14.4	1.42	1.43	−4.1	0.50	2.37
South Korea	+26.3 Aug	+27.6 Jul	+3.2	1,227	1,095	−5.0	2.57	5.23
Taiwan	+18.0 Aug	+31.9 Q2	+10.3	32.7	31.9	−5.2	0.85	1.34
Thailand	+11.3 Jul	+9.0 Jul	+5.5	34.0	34.6	−5.8	1.35	3.16
Argentina	+17.5 Jul	+6.8 Q1	+3.4	3.85	3.07	−0.9	13.81	na
Brazil	+27.8 Aug	−17.9 Jul	−1.3	1.82	1.79	−2.6	8.65	6.16‡
Chile	+6.0 Aug	−3.6 Q2	−0.9	552	533	−4.0	0.48	2.04‡
Colombia	−0.8 Jul	−6.5 Q1	−3.3	1,991	2,100	−3.0	4.94	5.48‡
Mexico	−16.0 Jul	−14.0 Q2	−2.4	13.4	10.6	−4.0	4.47	7.88
Venezuela	+18.5 Q2	+10.3 Q2	+0.7	6.34§	3.90§	−7.6	14.50	6.55‡
Egypt	−26.1 Q1	−2.9 Q1	−2.1	5.52	5.42	−6.9	9.59	2.84‡
Israel	−8.7 Jul	+4.1 Q1	+1.7	3.76	3.61	−5.7	0.70	4.01
Saudi Arabia	+212.0 2008	+134.0 2008	+5.6	3.75	3.75	−0.3	0.65	na
South Africa	−3.6 Jul	−15.8 Q2	−5.3	7.47	8.06	−4.5	6.98	8.50
MORE COUNTRIES Data for the countries below are not provided in printed editions of *The Economist*								
Estonia	−1.9 Jul	−0.5 Jun	+0.7	10.7	11.1	−3.5	5.58	na
Finland	+5.6 Jun	+3.1 Jun	+0.6	0.69	0.71	−2.8	0.76	3.67
Iceland	+0.7 Jul	−4.5 Q2	−5.9	124	90.8	−13.3	8.29	na
Ireland	+49.8 Jun	−11.3 Q1	−3.0	0.69	0.71	−13.0	0.78	4.89
Latvia	−3.8 Jun	−0.7 Jun	+2.0	0.48	0.50	−11.0	9.47	na
Lithuania	−3.9 Jun	−1.5 Jun	+1.3	2.37	2.46	−7.0	7.34	na
Luxembourg	−6.9 Jun	+2.2 Q1	na	0.69	0.71	−4.0	0.78	na
New Zealand	−2.1 Jul	−11.8 Q1	−7.7	1.43	1.50	−6.8	3.70	5.70
Peru	+2.5 Jul	−2.1 Q2	−2.3	2.92	2.97	−2.3	1.25	na
Philippines	−6.9 Jun	+5.1 Mar	+4.5	48.4	47.0	−3.1	4.31	na
Portugal	−27.5 Jul	−24.2 Jun	−8.8	0.69	0.71	−7.4	0.78	3.98
Slovakia	−0.3 Jun	−4.3 Jun	−4.0	20.7	21.5	−5.5	1.35	3.91
Slovenia	−2.9 Jun	−1.9 Jun	−1.6	0.69	0.71	−5.7	0.78	na
Ukraine	−13.4 Q1	−6.5 Q2	−0.5	8.43	4.77	−7.0	13.42	na
Vietnam	−6.6 Aug	−7.0 2007	−6.9	17,830	16,580	−9.0	8.77	6.29

*Merchandise trade only. †The Economist poll or Economist Intelligence Unit forecast. ‡Dollar-denominated bonds. §Unofficial exchange rate.



Markets

Sep 10th 2009
From The Economist print edition

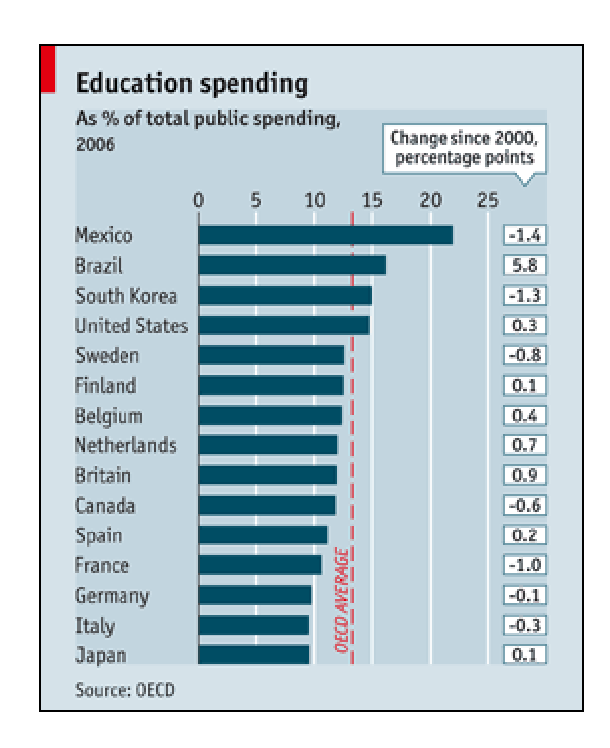
Markets

	Index Sep 9th	% change on one week	% change on Dec 31st 2008 in local currency	% change on Dec 31st 2008 in $ terms
United States (DJIA)	9,547.2	+2.9	+8.8	+8.8
United States (S&P 500)	1,033.4	+3.9	+14.4	+14.4
United States (NAScomp)	2,060.4	+4.7	+30.7	+30.7
Japan (Nikkei 225)	10,312.1	+0.3	+16.4	+15.0
Japan (Topix)	939.8	−1.0	+9.4	+8.1
China (SSEA)	3,092.1	+8.5	+61.7	+61.6
China (SSEB, $ terms)	200.6	+7.1	+81.0	+80.8
Britain (FTSE 100)	5,004.3	+3.9	+12.9	+30.0
Canada (S&P TSX)	11,000.2	+2.8	+22.4	+40.4
Euro area (FTSE Euro 100)	870.4	+4.3	+16.6	+22.3
Euro area (DJ STOXX 50)	2,820.6	+4.3	+15.2	+20.9
Austria (ATX)	2,527.0	+5.4	+44.3	+51.4
Belgium (Bel 20)	2,446.6	+6.8	+28.2	+34.5
France (CAC 40)	3,707.7	+3.8	+15.2	+20.9
Germany (DAX)*	5,574.3	+4.8	+15.9	+21.6
Greece (Athex Comp)	2,534.6	+2.3	+41.9	+48.8
Italy (FTSE/MIB)	22,802.0	+4.7	+17.2	+22.9
Netherlands (AEX)	304.3	+5.3	+23.7	+29.8
Spain (Madrid SE)	1,199.9	+4.5	+22.9	+29.0
Czech Republic (PX)	1,152.9	+2.9	+34.3	+48.9
Denmark (OMXCB)	316.5	+4.1	+39.9	+46.8
Hungary (BUX)	19,018.0	+3.6	+55.4	+59.9
Norway (OSEAX)	361.3	+5.5	+33.7	+59.0
Poland (WIG)	37,534.5	+4.9	+37.8	+44.9
Russia (RTS, $ terms)	1,159.8	+10.1	+86.4	+83.5
Sweden (OMXS30)†	921.5	+5.5	+39.1	+57.1
Switzerland (SMI)	6,202.0	+1.9	+12.1	+14.7
Turkey (ISE)	44,585.1	−2.6	+66.0	+72.0
Australia (All Ord.)	4,527.1	+2.0	+23.7	+51.4
Hong Kong (Hang Seng)	20,851.0	+6.8	+44.9	+44.9
India (BSE)	16,183.6	+4.6	+67.8	+68.5
Indonesia (JSX)	2,383.3	+4.3	+75.8	+93.1
Malaysia (KLSE)	1,196.5	+2.4	+36.5	+35.0
Pakistan (KSE)	9,085.0	+2.3	+54.9	+47.8
Singapore (STI)	2,650.5	+3.1	+50.5	+52.3
South Korea (KOSPI)	1,607.8	−0.3	+43.0	+46.8
Taiwan (TWI)	7,250.7	+3.0	+57.9	+58.4
Thailand (SET)	695.6	+6.3	+54.6	+58.1
Argentina (MERV)	1,874.3	+6.9	+73.6	+55.5
Brazil (BVSP)	57,909.0	+4.6	+54.2	+97.2
Chile (IGPA)	15,181.3	+1.6	+34.1	+54.9
Colombia (IGBC)	10,627.9	+2.6	+40.6	+58.7
Mexico (IPC)	29,100.1	+4.1	+30.0	+34.6
Venezuela (IBC)	52,710.0	+3.4	+50.2	+61.7
Egypt (Case 30)	6,655.5	+1.7	+44.8	+44.5
Israel (TA-100)	904.8	+2.1	+60.4	+60.9
Saudi Arabia (Tadawul)	5,713.0	+1.7	+18.9	+19.0
South Africa (JSE AS)	25,085.9	+2.2	+16.6	+44.3
Europe (FTSEurofirst 300)	987.9	+3.9	+18.7	+24.6
World, dev'd (MSCI)	1,106.3	+4.5	+20.2	+20.2
Emerging markets (MSCI)	879.9	+5.9	+55.2	+55.2
World, all (MSCI)	281.3	+4.6	+23.5	+23.5
World bonds (Citigroup)	834.7	+1.0	+3.1	+3.1
EMBI+ (JPMorgan)	470.6	+1.6	+20.2	+20.2
Hedge funds (HFRX)§	1,117.6	+0.9	+9.5	+9.5
Volatility, US (VIX)	24.3	28.9	40.0	(levels)
CDSs, Eur (iTRAXX)‡	105.2	−4.6	−47.9	−45.4
CDSs, N Am (CDX)‡	172.5	−2.2	−26.1	−26.1
Carbon trading (EU ETS) €	15.2	+0.7	−5.9	−1.3

*Total return index. †New series. ‡Credit-default swap spreads, basis points. Sources: National statistics offices, central banks and stock exchanges; Thomson Reuters; WM/Reuters; JPMorgan Chase; Bank Leumi le-Israel; CBOE; CMIE; Danske Bank; EEX; HKMA; Markit; Standard Bank Group; UBS; Westpac. §Sep 8th

Education spending

Sep 10th 2009
From The Economist print edition



As public finances worsen, few areas of government spending are likely to escape close scrutiny. Education, which accounted for 13.3% of public spending in OECD countries in 2006, now faces some lean years. Pay rises for teachers may be off the agenda; school class sizes are unlikely to keep falling; decrepit buildings may have to serve a few more years. Countries where the taxpayer funds higher education may have to ask students to part-finance their tuition, or else see their campuses crumble and become more crowded, and their professors flee abroad in search of higher pay. In some rich countries, such as France and Sweden, the share of public spending going to education was falling even before the economic crisis.